MUMBAI

INDIA: Growth risk and policy space

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Agenda

Global Recession

Why India got hit

How the adjustment might look

Growth risks

Policy space

Recession goes global

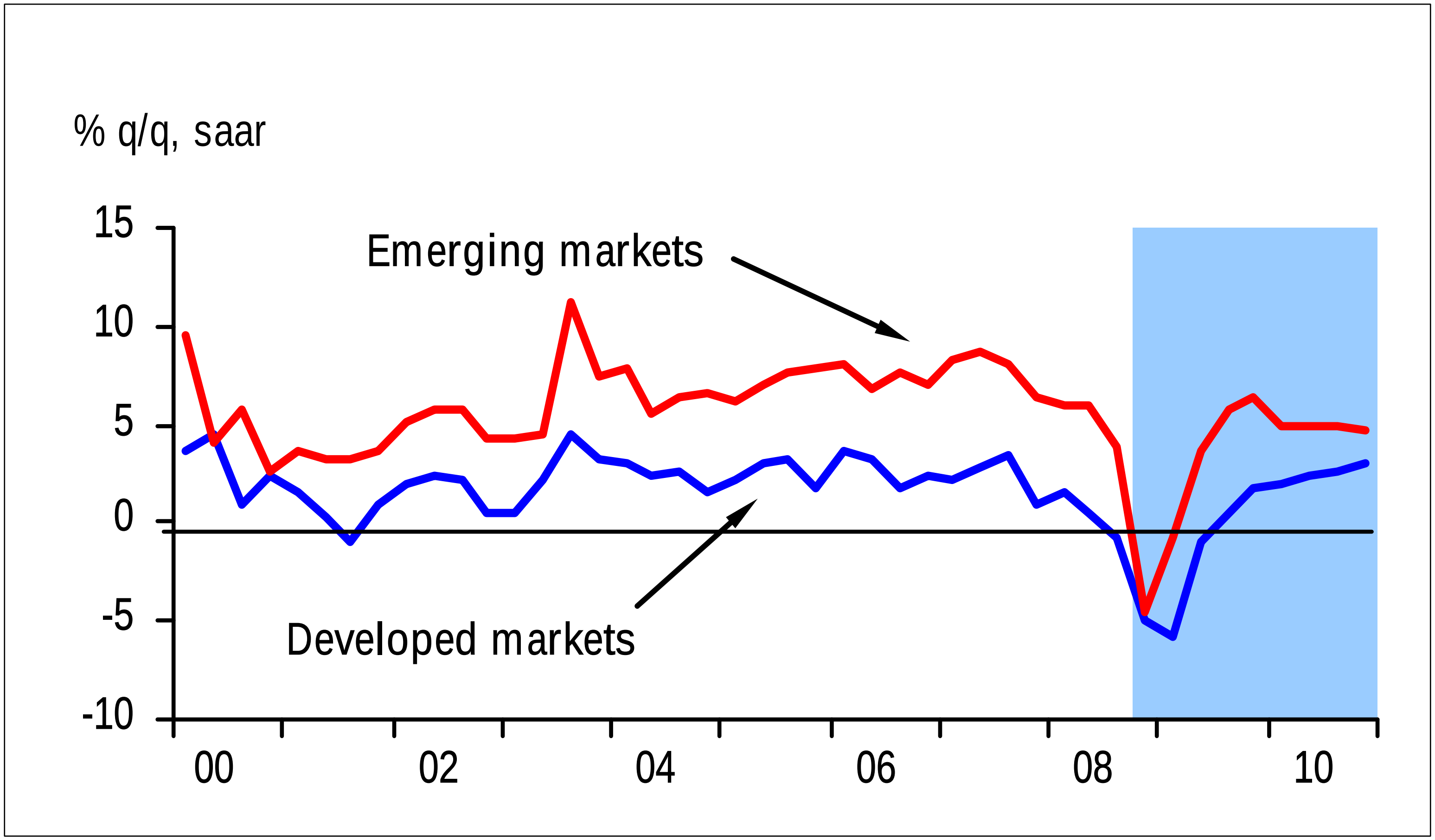
Global Real GDP

	% over year ago			% over previous period , saar					
	2008	**2009**	**2010**	**3Q08**	**4Q08**	**1Q09**	**2Q09**	**3Q09**	**4Q09**
United States	1.3	-1.8	2.5	-0.5	-3.8	-5.5	-0.5	1.5	2.5
Japan	-0.4	-5.7	2.2	-1.8	-9.0	-12.0	-2.5	-1.0	2.0
Euro area	0.8	-2.2	0.8	-0.7	-5.0	-4.0	-1.0	0.0	1.0
United Kingdom	0.7	-2.9	1.0	-2.6	-5.9	-5.0	-1.5	0.0	1.0
Asia ex. Japan	6.0	3.4	6.6	3.6	-4.6	1.3	6.7	8.6	9.0
China	9.0	7.2	8.5	5.5	1.5	5.1	10.0	11.7	12.6
India	6.2	5.5	7.7	8.7	0.3	0.1	4.8	8.9	10.9
Latin America	4.1	-0.4	3.2	4.2	-4.7	-3.2	-0.3	2.7	3.1
Emerging Europe	4.6	-1.1	2.2	5.0	-4.7	-4.1	-1.7	0.1	1.1
Global	1.7	-1.7	2.4	0.1	-4.9	-4.8	-0.1	1.6	2.7
Developed markets	0.8	-2.6	1.8	-0.8	-5.0	-5.9	-1.1	0.5	1.8
Emerging markets	5.2	1.6	4.9	3.9	-4.5	-0.6	3.6	5.8	6.3

Source: JP Morgan Datawatch January 31, 2009

Global downturn deep but short-lived; at least for now!

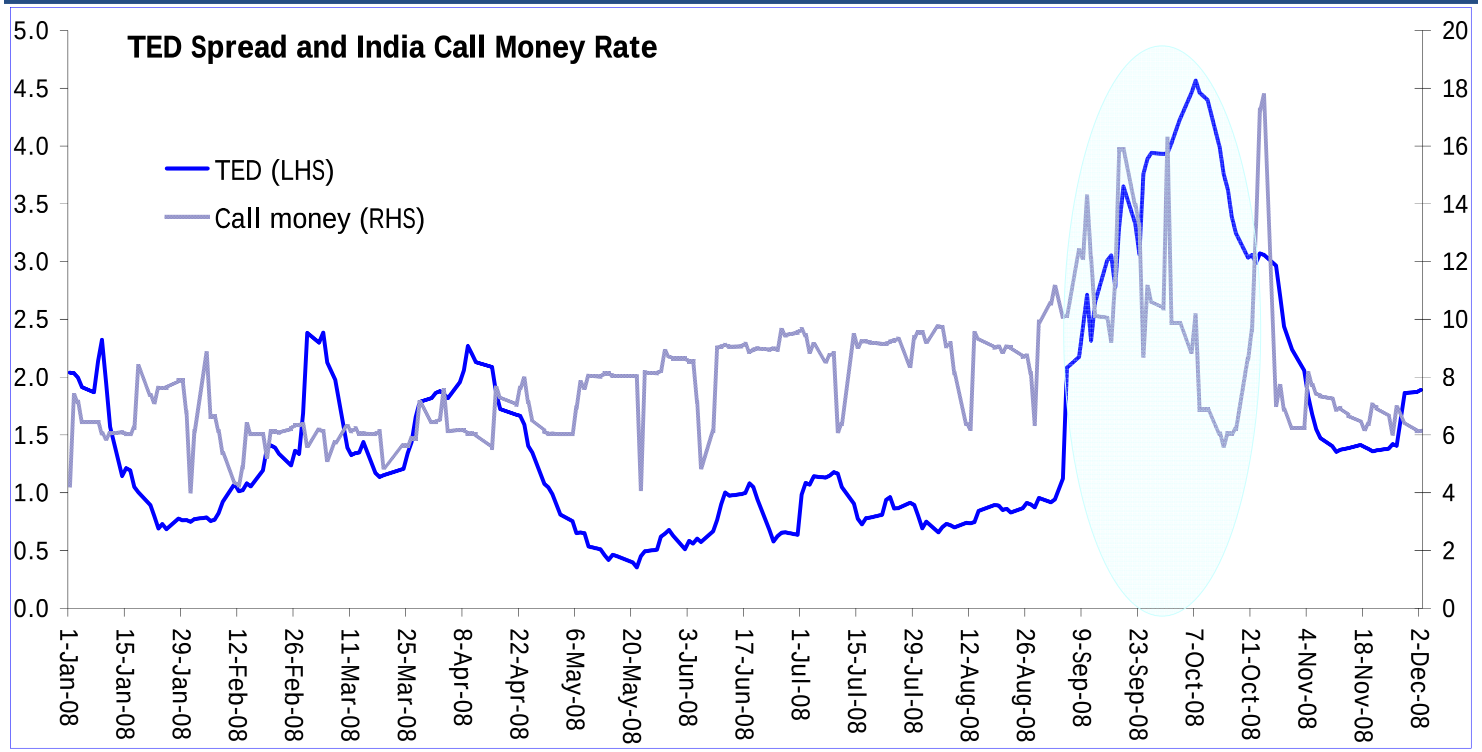
Real GDP growth Developed and Emerging Markets



Source: J.P. Morgan economics. Chart shows real GDP growth QoQ saar. Shaded area forecasts.

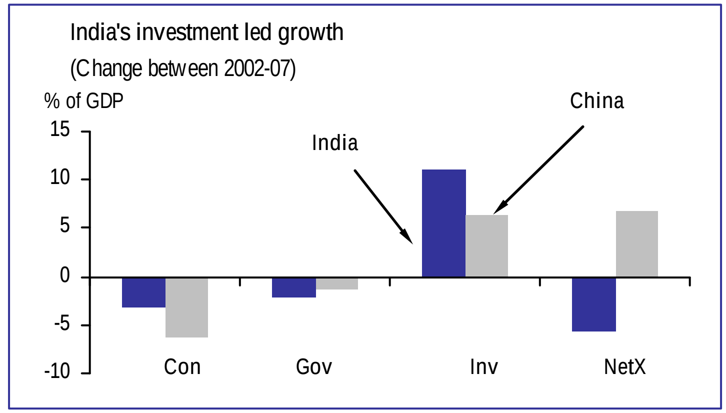
Why India got hit?

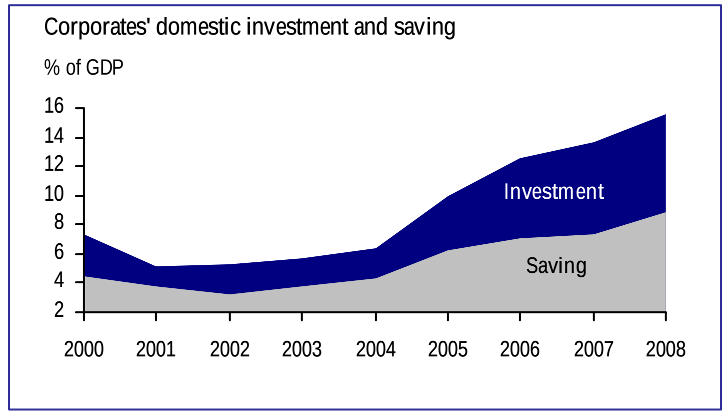
FROM LONDON TO MUMBAI

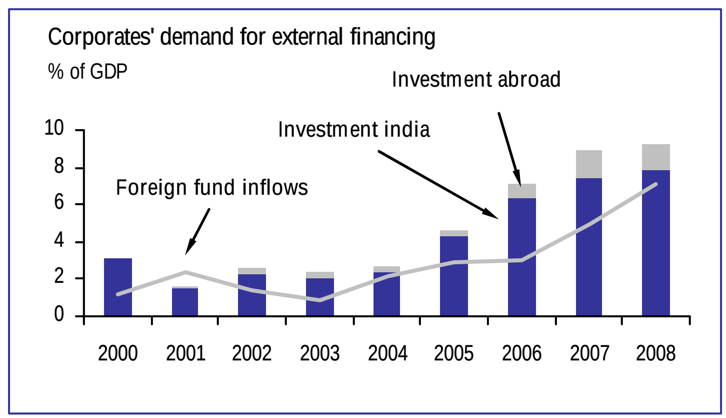


Sudden stop in external financing: part coincidental, part structural

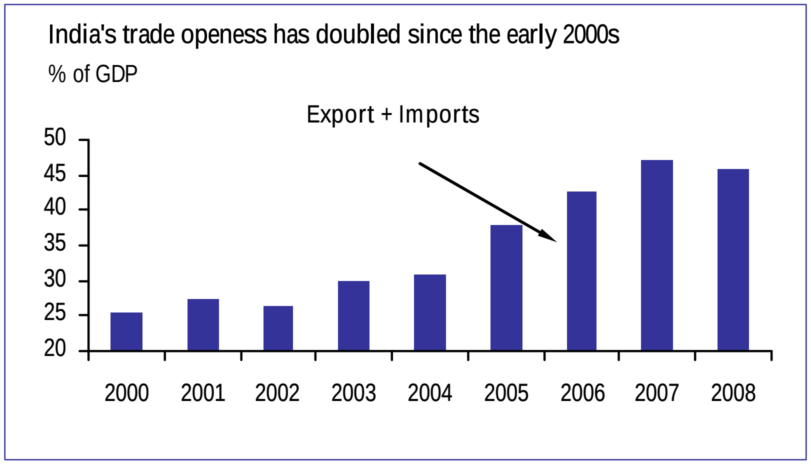
- Dependence of corporates and banks on external funds
- Dependence of non-bank financials (NBFCs) and mutual funds (MFs) on domestic money market and corporate investments
- Dependence of SMEs, real-estate, and consumers on NBFCs and MFs
- Segmented domestic financial market—regarded as a buffer to shocks—became a key vulnerability, exacerbating price volatility

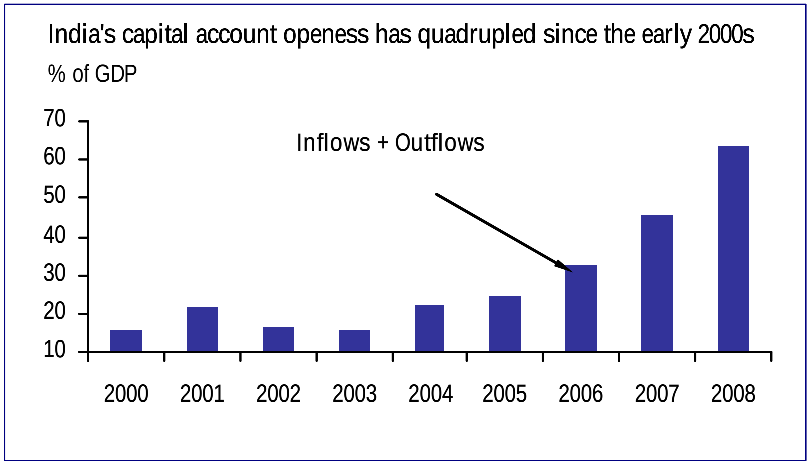


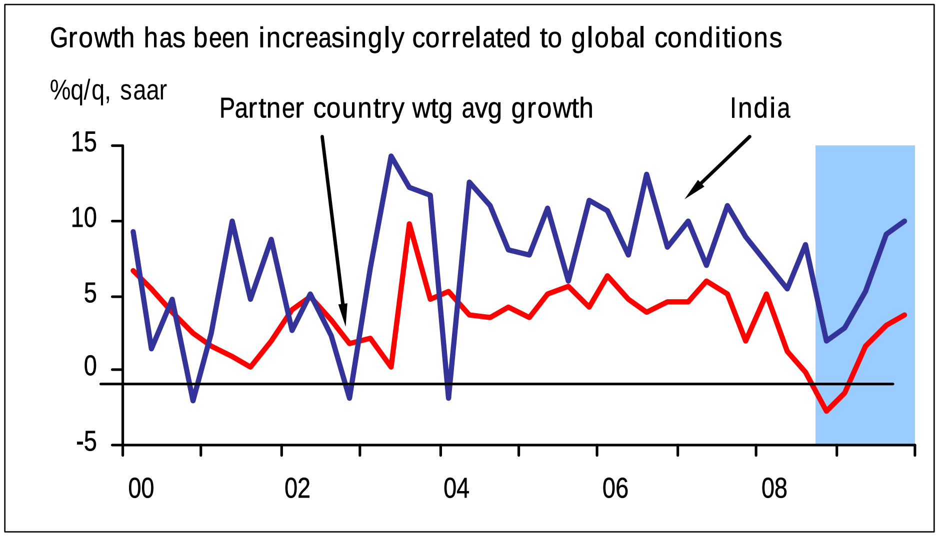




Decoupling anyone? external openness has increased sharply



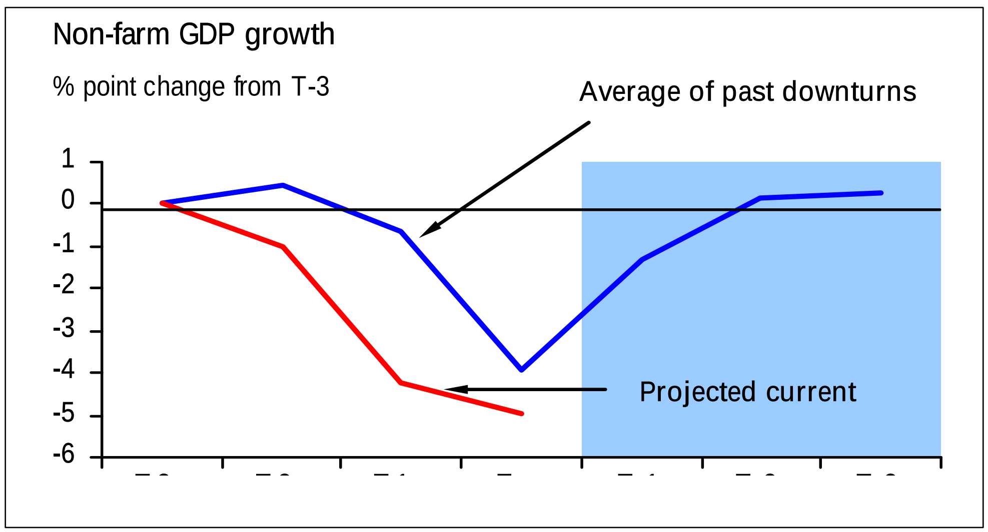




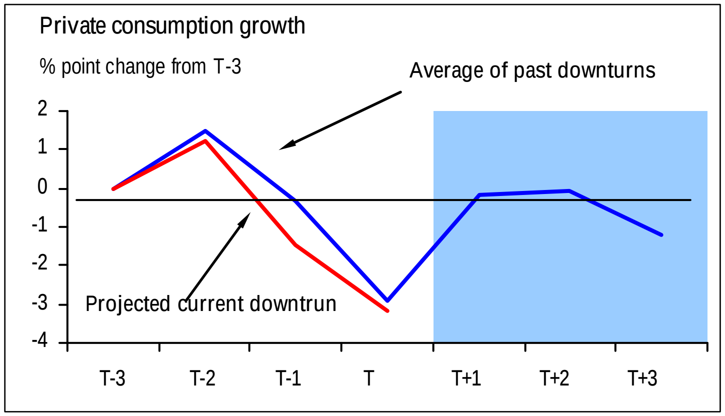
How the adjustment might look: a V-shaped recovery still likely ...

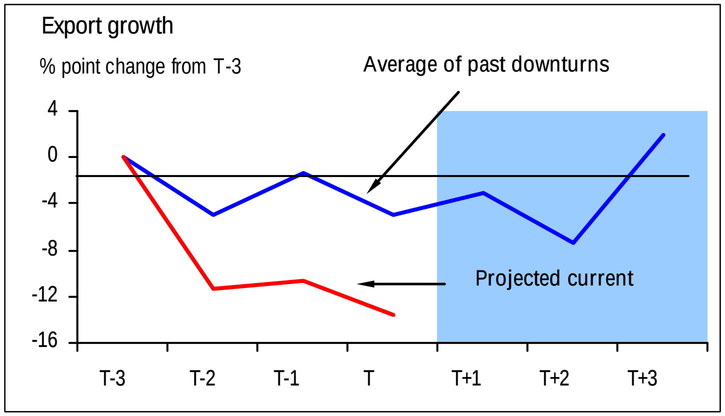
GDP: expenditure-side details
%y/y, fiscal year beginning April 1

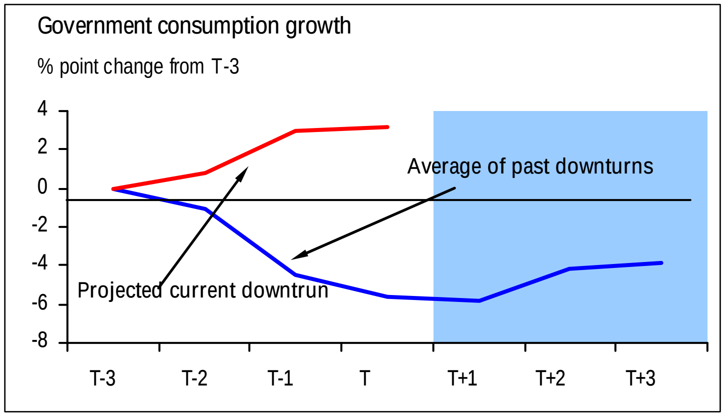
	Private cons	Government spending	Investment	Exports	Imports	GDP	Inflation
2001-02	6.1	2.3	-2.9	5.7	3.4	5.2	3.6
2002-03	2.7	-0.4	17.0	21.8	10.4	3.8	3.4
2003-04	5.8	2.6	19.9	5.8	16.8	8.4	5.5
2004-05	5.2	2.6	19.5	28.1	16.0	8.3	6.5
2005-06	8.7	5.4	19.4	14.8	45.6	9.2	4.4
2006-07	7.1	6.2	10.9	18.9	24.5	9.7	5.4
2007-08	8.3	7.0	13.7	7.5	7.7	9.0	4.6
2008-09f	5.6	9.1	7.1	8.5	12.1	6.2	8.6
2009-10f	4.9	9.4	4.8	3.7	3.4	5.5	0.7
2010-11f	6.5	9.0	14.0	15.0	19.0	7.7	3.1

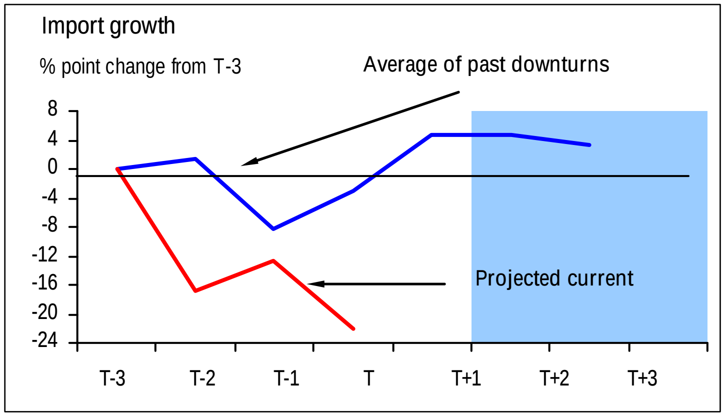


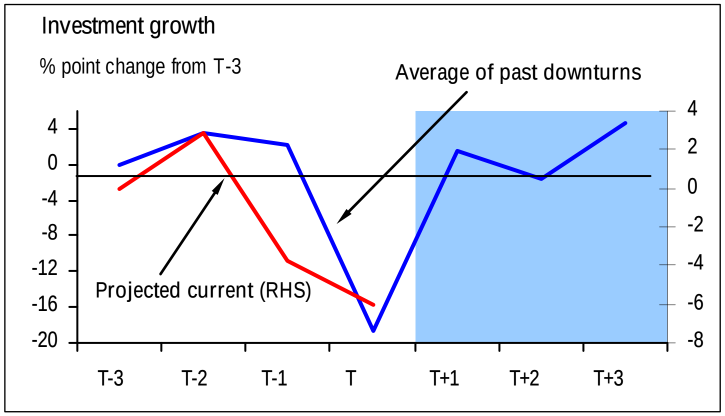
… on investment dynamics

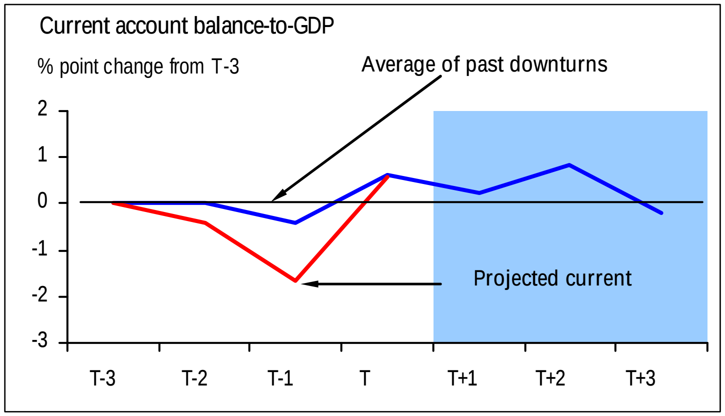




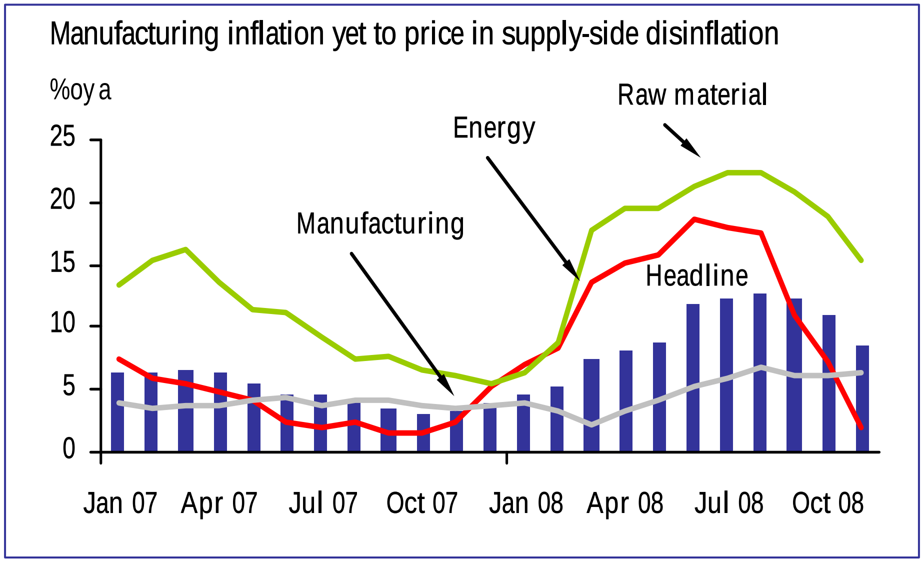


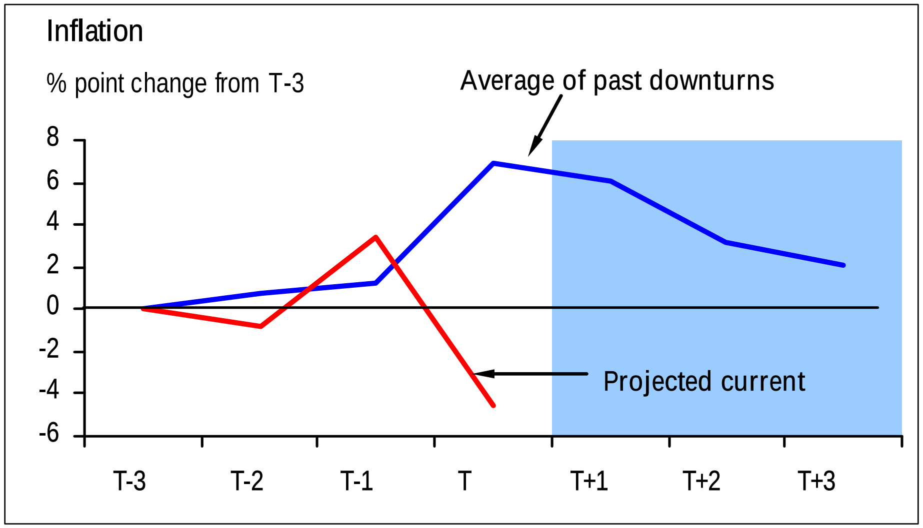




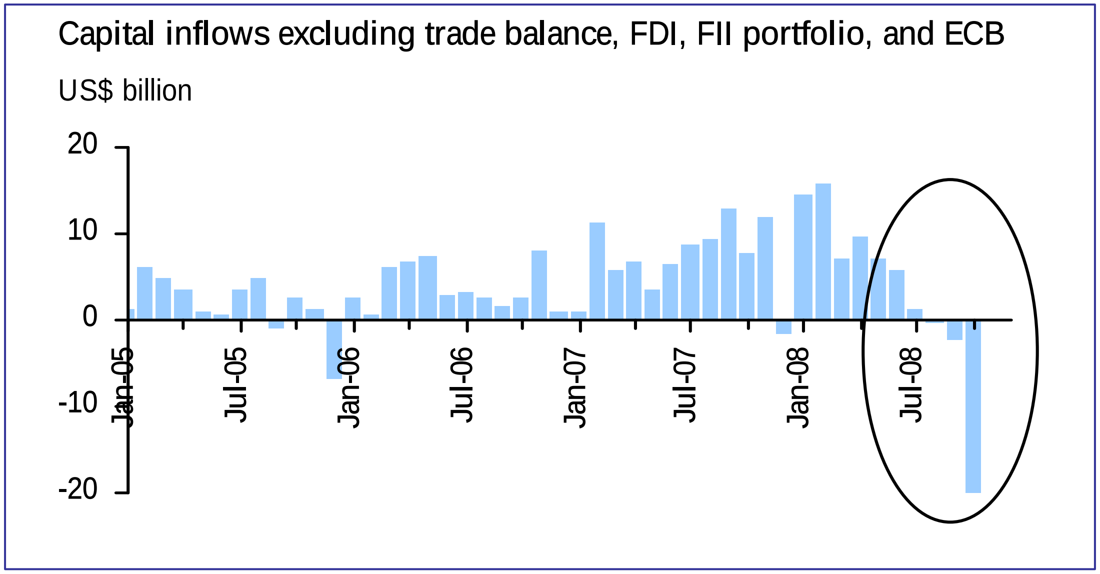


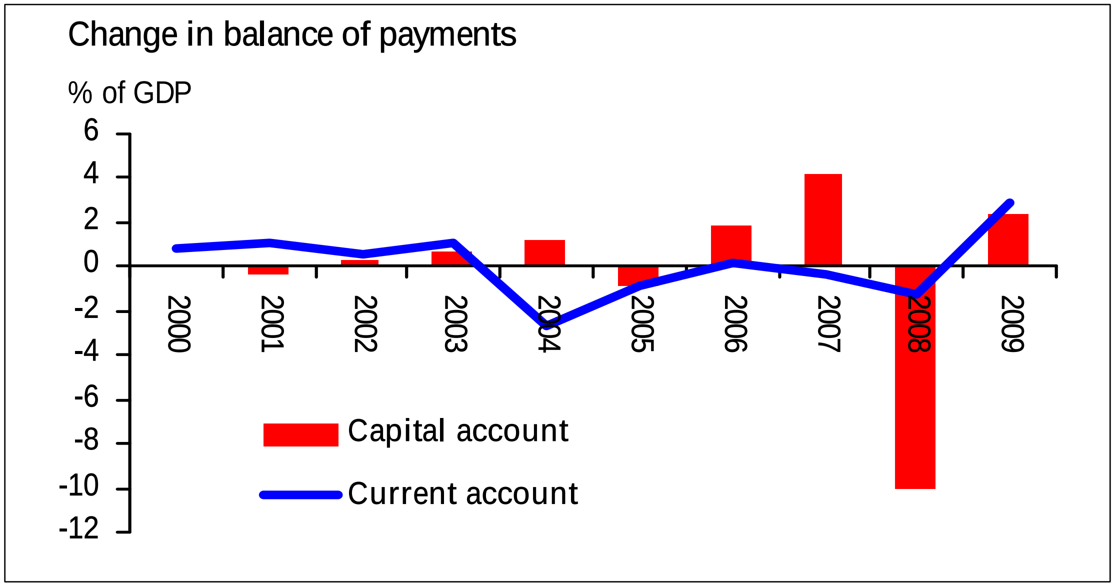
Inflation to fall and stay low



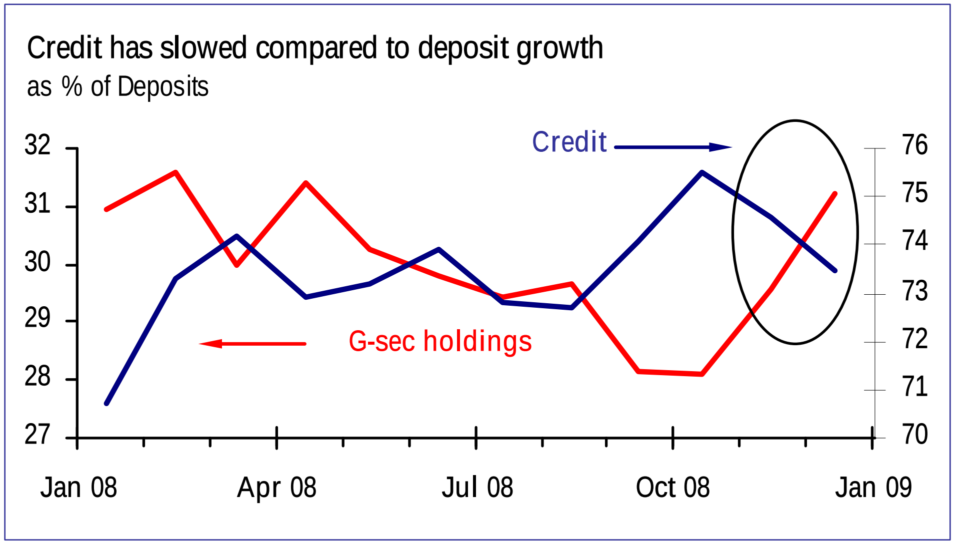


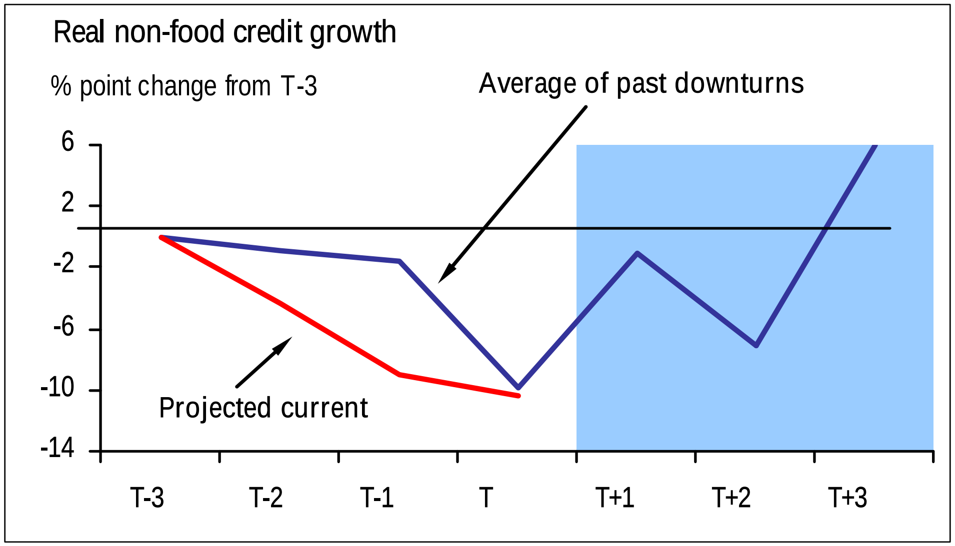
Q4 BOP carnage unlikely to be repeated; CA to take over INR dynamics



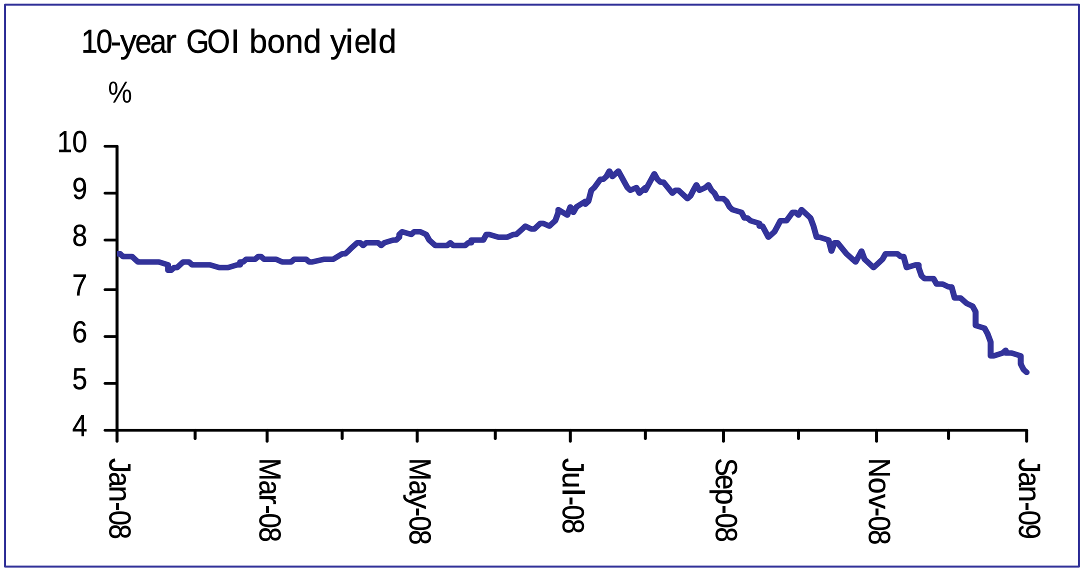


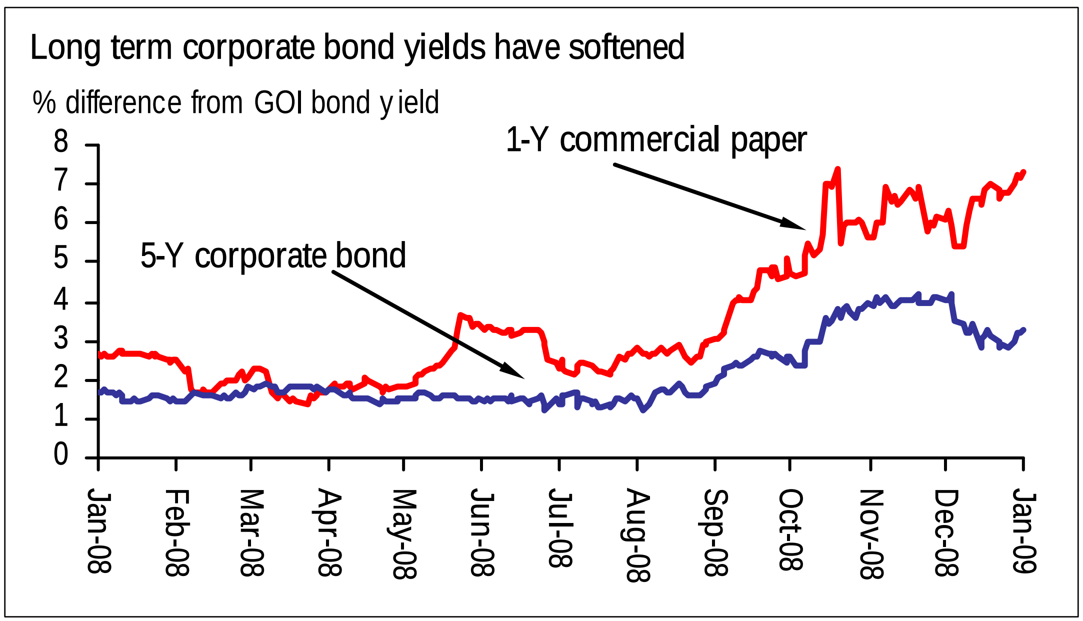
Credit growth to slow appreciably



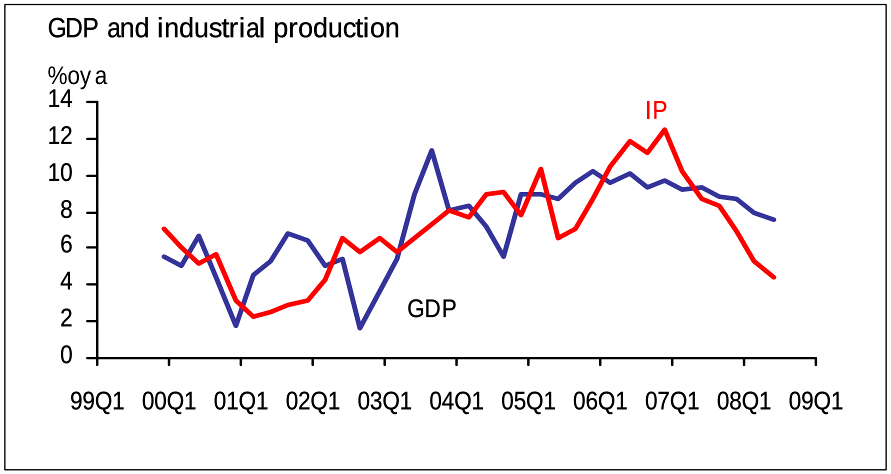


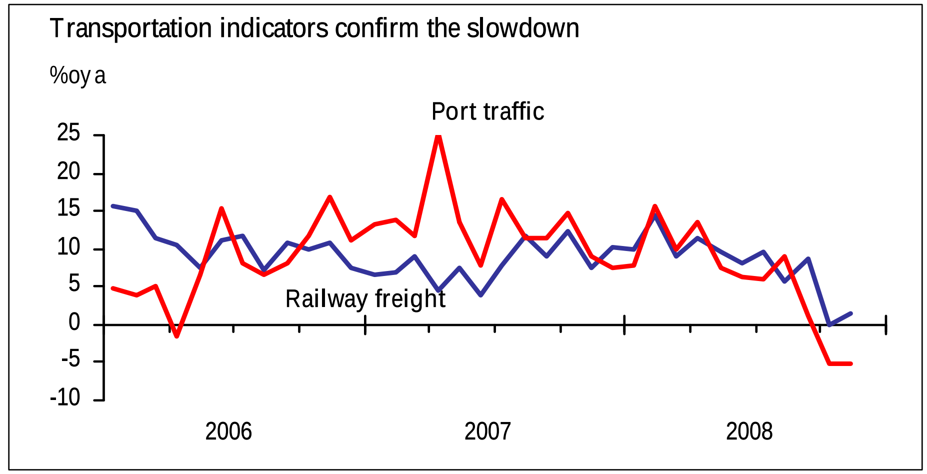
GOI yields to fall; corporate bond could be a pleasant surprise

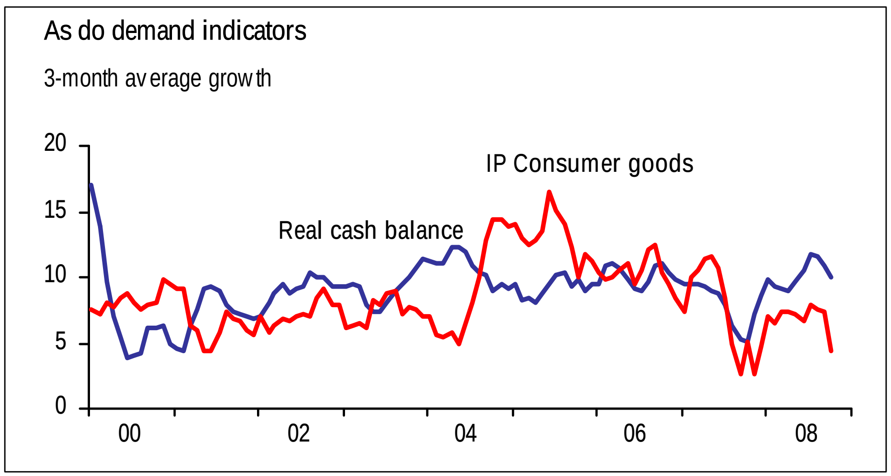


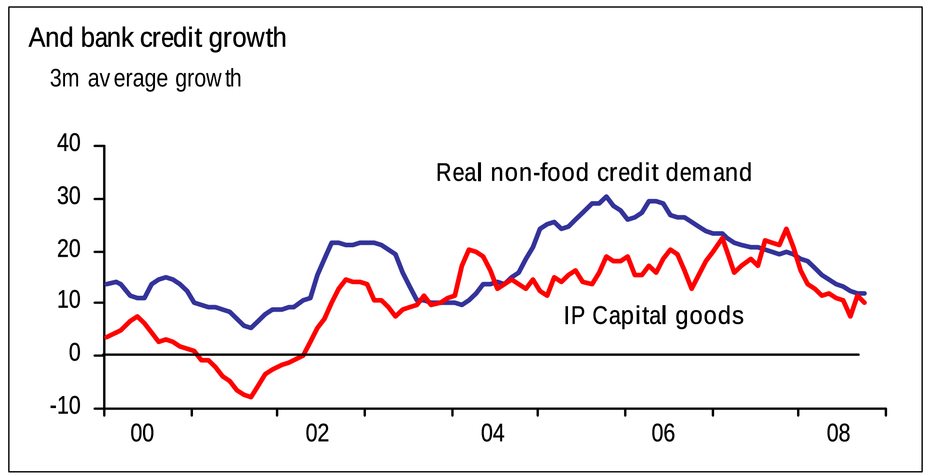


Growth risks: protracted global recession

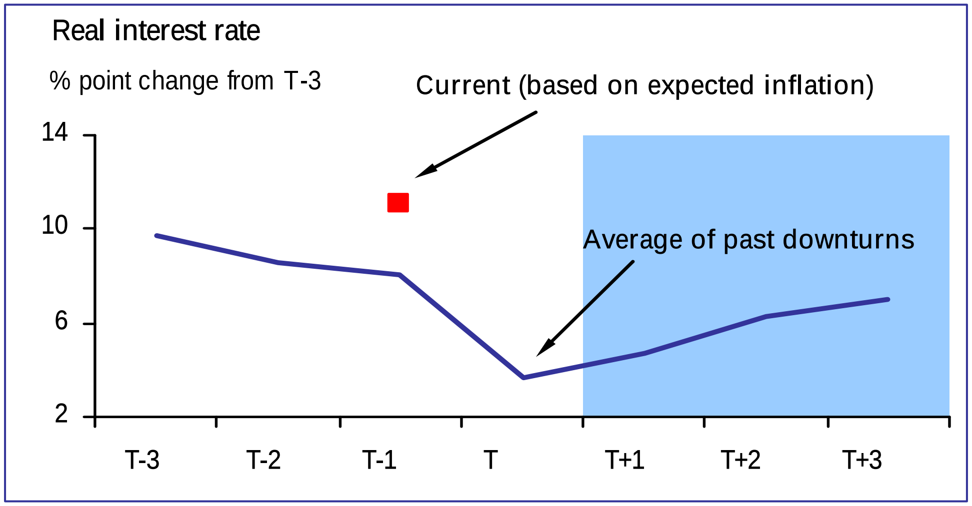


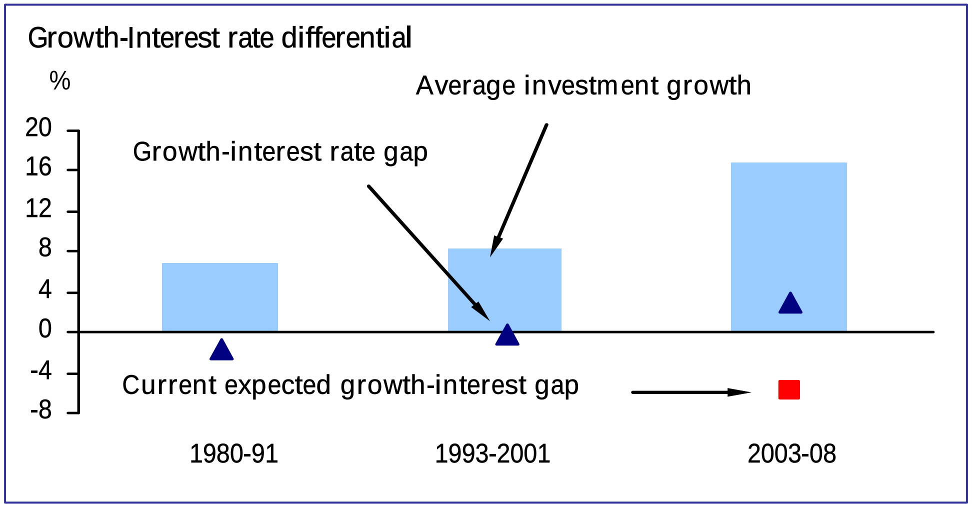






Slow price adjustment: rentals and interest rates





Other risks:

- **Will banks lend?** Bank debt restructuring and RBI forbearance important
- **Who will bear the risk?** Expecting banks to take all the risk unreasonable and unwise. Corp bond market needs to be supportive
- **Coming elections:** overplayed; but monetary policy only effective lever until new gov forms
- **Security concerns:** so far restricted to tourism

Policy Space: rate cuts and more

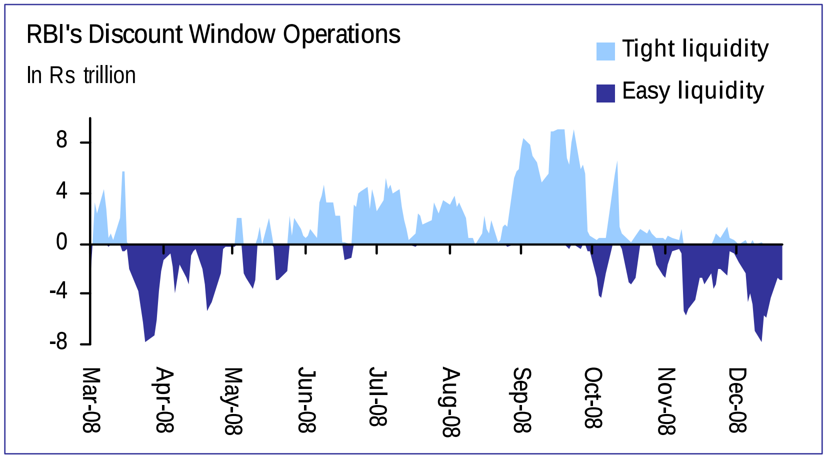
Undertaken

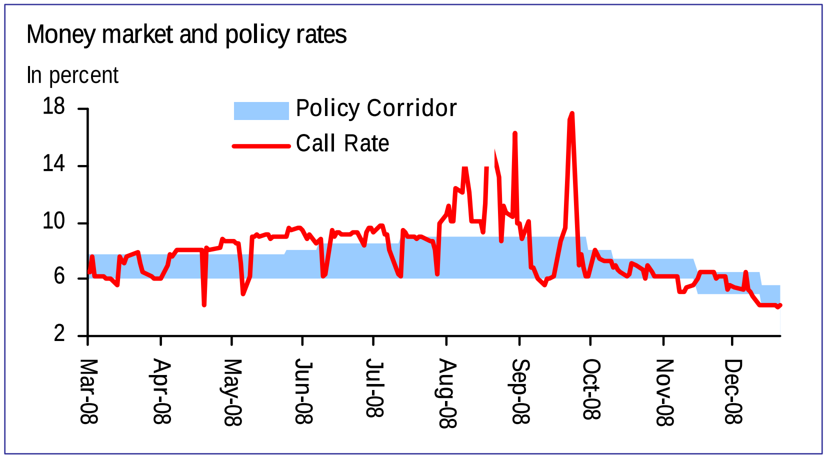
- Repo rate cut from 9% to 5.5%
- Reverse repo cut from 6% to 4%
- Cash reserve ratio (CRR) cut from 9% to 5%
- Statutory liquidity ratio (SLR) cut
  - 100bp permanently
  - 100bp for 90 days
  - 150bp for loans to NBFC & MFs
- Dollar-swap arrangements with banks
- Extension of forbearance: Lower risk weight, lower provisioning , easier loan classification
- Special refinance for NBFCs, MFs, real-estate and SMEs
- Easier export credit terms

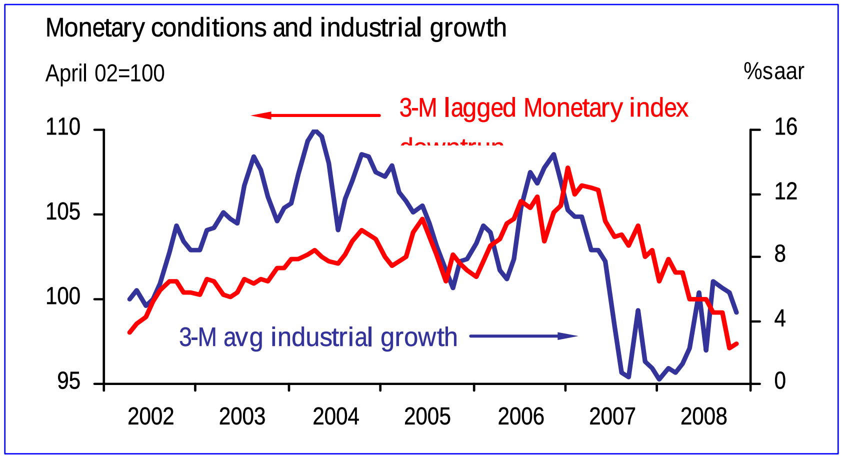
Expected

- Repo rate cut another 100-150bp by April
- Reverse repo another 100bp by April
- CRR cut 100bp by April
- SLR not binding at present, cut only if needed
- More forbearance: needed to encourage debt restructuring
- More refinance facilities for specific sectors

Monetary policy transmission weak but still effective







Fiscal policy: more space than meets the eye

Undertaken

- October: 3.3% of GDP
  - 1.9% of GDP in cash
  - 1.4% of GDP in bonds
- December: 0.5-0.7% of GDP
  - Expenditure 0.4% of GDP
  - Tax cuts of 0.15% of GDP
  - Support for export, textile, housing, SME
  - Cuts in retail gasoline price
- January: 1.5-1.8% of GDP (budget + other)
  - Infrastructure refinancing Rs 400bn
  - SPV for NBFCs worth Rs 250bn
  - State borrowing Rs 300bn
- Central government deficit could rise to 6.5% of GDP from 3.7% of GDP last year
- Borrowing in Q1 09 Rs1.1tn (3% of deposit)
- Window for more support closed for FY09

Expected

- **FY10 budget deficit 6.2-6.5% of GDP**
- **Less oil and fertilizer subsidy opens up 1.5-2% of GDP space**
- **Debt high (82% of GDP by FY09), but so are assets; divesting when cash strapped typically weakens political opposition**
- **Lower GOI interest rates will help stabilize debt dynamics**
- **Fears of crowding out overplayed in H1 FY10, concern in H2 FY10**
- **FRBM-II likely in FY10**
- **Consolidation not before FY11**
- **Divestment important to balance stimulus with sustainable debt**

Capital controls: time for regime change

Undertaken	Expected
■ Cap on ECB interest removed but approval still needed	■ Gradual removal of NRI deposit cap
■ ECB extended to NBFCs to refinance infra loans	■ Gradual removal of FII limit in corporate bonds
■ Cap on NRI deposit raised	■ Some increase in FII limit in GOI bonds (likely with SLR reduction)
■ FII limit on corporate bond raised to \$15bn from \$6bn	■ Gradual removal of sector restrictions for VC and PE
	■ Move towards QFI from FII regime

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