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BUDGET 2016

Understanding the Business Impact

Economic Indicators 2015-16

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India exhibits resilience despite global headwinds

The Finance Minister of India presented the Economic Survey for the year 2015-16 in Parliament on 26 February 2016. The key economic indicators relevant for FPIs are discussed below.

State of the Indian Economy

India bright spot in slowing global economy: IMF chief Christine Lagarde

India has registered a robust and steady economic growth in the current financial year (April 2015 to March 2016) despite turbulent external environment. The country's Gross Domestic Product (GDP) growth rate in the current year is estimated to be 7.6% compared with 7.2% in the last financial year. When compared with the average global growth of 3.1% in 2015 estimated by International Monetary Fund (IMF) & the fact that emerging economies are consistently experiencing declining trend in growth rate since 2010, India's growth rate of 7.6% appears really promising. Considering the consistent growth rate witnessed in the past years, India now contributes around 7% to world GDP as per IMF estimates. The primary reason for strong growth in the current year is increase in private final consumption. Also, in line with overall GDP growth, the per capita GDP growth rate has increased to 6.2% in the current year from 5.9% in the last year.

The Government has stated that the fiscal deficit target of 3.9% of GDP for the current financial year seems achievable. This has been possible primarily because of buoyancy in tax collections, steep decline in oil prices and prudent expenditure management. The decline in oil prices have also helped moderation in country's Current Account Deficit (CAD) despite its exports suffering from the global slowdown.

Inflation rate in the country has been on a consistent moderation trend. The headline inflation based on Consumer Price Index (CPI) series has declined to 4.9% in the current financial year (upto January 2016) as against 5.9% in the last financial year. The headline Wholesale Price Index (WPI) inflation has remained in the negative territory since November 2014 and was -2.8% in the current financial year (upto January 2016) as against 2% in the last financial year. The primary reason for moderation in inflation is decline in global commodity prices especially oil prices. The moderation in inflation has given room to the Reserve Bank of India (RBI) to bring down the interest (repo) rates from 8% at the start of 2015 to 6.75% currently.

The average exchange rate of INR has depreciated to 65.04 per USD in the current financial year (upto January 2016) against 60.92 per USD in the last financial year depicting a decline of 6.76%. This decline can be attributed to strengthening of USD against all other major currencies because of stronger growth in US and flight of capital from emerging economies.

The Government's outlook for the upcoming financial year 2016-17 appears cautiously optimistic. Considering the resilience in the domestic economy, the GDP growth for year 2016-17 is estimated to be between 7% to 7.75%. However, this estimated rate is subject to downside risks, especially the sluggish global demand.

Note:

Na : Not Available,

2R : Second Revised Estimates

1R: First Revised Estimates

AE : Advance Estimates

a: 2nd Advance Estimates

b: Base (2004-05=100)

c : As at end-January 2016

d : April-December 2015-16

e : April-January 2015-16

f : April-September 2015-16

g : y-o-y growth rate as on January 08, 2016

h : Budget Estimates

i : Provisional Actuals

*INR 1 Crore = Indian Rupee 10 million = Approx. USD 147,327
(Conversion 1USD = INR 67.8763)

The key economic indicators for the financial year 2015-16 are:

Data categories	Unit	2012-13	2013-14	2014-15	2015-16
GDP and Related Indicators					
GDP (2011-12 prices)	INR Crore*	9226879[2R]	9839434[2R]	10552151[1R]	11350962[AE]
Growth Rate	%	5.6	6.6	7.2	7.6
GVA at Basic prices (2011-12 prices)	INR Crore*	8546552[2R]	9084369[2R]	9727490[1R]	10437579[AE]
Growth Rate	%	5.4	6.3	7.1	7.3
Saving Rate	% of GDP	33.8	33.0	33.0	Na
Capital Formation (rate)	% of GDP	38.6	34.7	34.2	Na
Per Capita Net National Income (At current market prices)	INR	71050	79412	86879	93231
Production					
Food grains	Million tonnes	257.1	265.0	252.0	253.2[a]
Index of Industrial Production [b] (growth)	%	1.1	-0.1	2.8	3.1[d]
Electricity Generation (growth)	%	4.0	6.0	8.4	4.4[d]
Prices					
Inflation (WPI) (average)	%	7.4	6.0	2.0	- 2.8[e]
Inflation CPI (Combined) (average)	%	10.2	9.5	5.9	4.9[e]
External Sector					
Export growth (US$)	%	-1.8	4.7	-1.3	-17.6[e]
Import growth (US$)	%	0.3	-8.3	-0.5	-15.5[e]
Current Account Balance (CAB)/GDP	%	-4.8	-1.7	-1.3	-1.4[f]
Foreign Exchange Reserves	US$ billion	292.0	304.2	341.6	349.6[c]
Average Exchange Rate	INR /US$	54.40	60.51	61.14	65.03[e]
Money and Credit					
Broad Money (M3) (annual)	% change	13.6	13.4	10.8	11.0[g]
Scheduled Commercial Bank Credit	% change	14.1	13.9	9.0	11.3[g]
Fiscal Indicators (Centre)					
Gross Fiscal Deficit	% of GDP	4.9	4.5	4.0[i]	3.9[h]
Revenue Deficit	% of GDP	3.7	3.2	2.9[i]	2.8[h]
Primary Deficit	% of GDP	1.8	1.1	0.8[i]	0.7[h]

Financial Intermediation and Markets

The Financial markets in India have been highly volatile in the current financial year. While the primary reason for such volatility is turbulence in global commodity and capital markets, there are also domestic reasons including weak growth in corporate earnings owing to sluggish demand and increase in gross non-performing assets (NPAs) of banks, especially public sector banks. The Fed rate hike last year coupled with slowdown in China and other emerging economies as well as the fall in global commodity markets resulted in flight of capital from emerging economies including India.

While moderation in inflation has allowed RBI to reduce the interest rate by 125 basis points in 2015, banks in India have not been able to fully percolate down the rate cut to the market due to structural rigidities in the credit market. Also, the increasing level of NPAs have reduced the banking sector's capacity to lend. The NPA problem in some sectors particularly has already become a cause of concern for the banking sector. Owing to the increasing NPAs and prudential norms pushed by RBI, some public sector banks have reported losses for the quarter ended 31 December 2015. That said, the long term projection for the banking sector is significantly optimistic considering the rising level of per capita income and the high level of un-banked section of the society. The recent initiative of Payment Banks implemented by RBI is expected to generate substantial economic activity as well as bring efficiency.

The 10 year benchmark Government bond yield which was at 7.78% at the start of financial year (April 2015) touched the highest level of 7.99% in May 2015, fell to 7.48% on 29 September 2015 (post 50 bps rate cut by RBI) and is currently hovering at 7.787%.

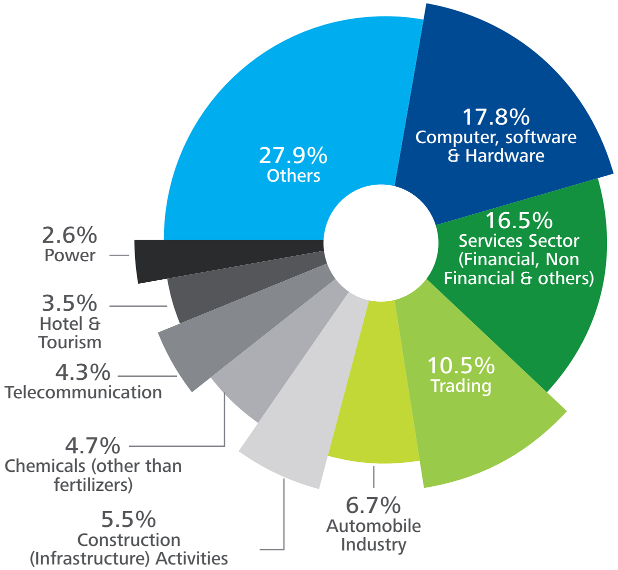
With a view to provide flexibility to Indian corporates and attract investments, the Government recently liberalized the External Commercial Borrowing (ECB) regulations and introduced Offshore INR denominated bonds ("Masala bonds"). The main highlights of the newly permitted Masala bonds are: a) Indian companies would not be exposed to currency risk on such bonds; and b) such bonds will enjoy a concessional withholding tax rate of 5% (plus surcharge and cess) on interest payments.

Foreign Direct Investments (FDI)

The Indian Government recently announced a number of reforms in the FDI regime including liberalization in sectors such as defence, construction, broadcasting, civil aviation, plantation, trading, private sector banking, satellite establishment and operation and credit information companies. These reforms have resulted in significant increase in FDI inflows. The total FDI inflows during April to November 2015 were USD 34.8 billion as compared to USD 27.7 billion in the corresponding period in 2014, registering an increase of 26%.

The below chart shows the sector-wise break-up of FDI inflows during April 2015 to November 2015

Sector-wise FDI Inflows during April 2015 to November 2015



Capital Markets

While the secondary markets experienced rough weather in the current financial year, resource mobilization through the public and right issues increased rapidly as compared to last year.

Primary Markets

In the current financial year (upto January 2016), 71 companies raised over USD 7 billion from the capital markets which is more than 4 times the capital raised in the last year. Further, Indian mutual funds raised over USD 23 billion during the current financial year registering over 80% growth from last year.

The following table provides the value of resources mobilized in the current financial year

Resource Mobilization in the Primary Market (INR crore*)

	2013-14	2014-15	2014-15#	2015-16#
Debt	42383	9713	7348	30421
Equity	13269	9789	4233	20890
of which IPOs	1236	3039	1420	12259
Pvt. Placement of corporate bonds	276054	404137	269245	341420
Total	331706	423639	280826	392731

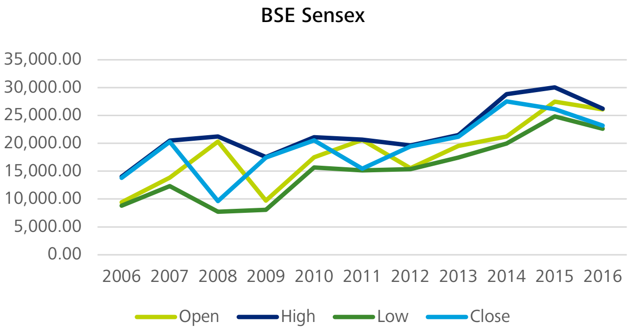
Source: SEBI

Notes:
IPO stands for initial public offerings;
# indicates as on 31 December of respective year
* INR 1 Crore = Indian Rupee 10 million = Approx. USD 147,327
(Conversion 1USD = INR 67.8763)

Secondary Markets

Secondary markets have had a rough going in the current financial year. The benchmark BSE Sensex has declined over 15 % in the year 2016 (till date) from the year 2014. The decline is mainly attributed to turmoil in global equity markets and consistent fall in commodity prices.

The below chart depicts movements in BSE Sensex from year 2006 to 2016:

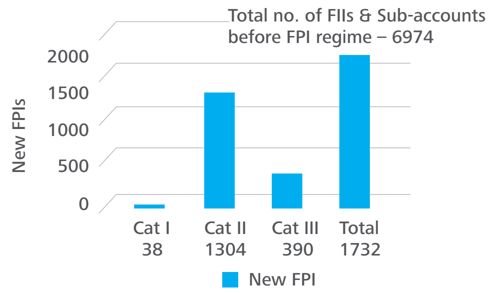


Foreign Portfolio Investors (FPI)

Effective June 2014, the erstwhile Foreign Institutional Investor (FII) regime was replaced with the FPI regime whereby FIIs, their sub-accounts and Qualified Institutional Investors (QFIs) were merged into a single investor class i.e. FPI. The regime change has also resulted in rationalization of FPIs into 3 categories based on their risk profile and privatization of the registration process from Securities and Exchange Board of India (SEBI) to the local custodians in their capacity of Designated Depository Participants.

Number of FPIs

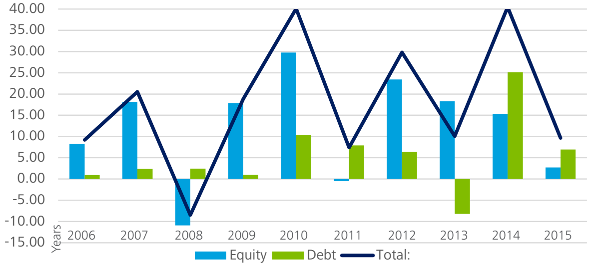
From June 2014 to January 2016, 1,732 new FPIs have obtained registration in India. The total number of FPIs as of 31 January 2016 (including the deemed FPIs i.e. erstwhile FIIs, Sub-accounts and QFIs) is 8,706.



Source: NSDL

FPI investments

The net FPI investments in calendar year 2015 have declined to around USD 9.64 billion as compared to USD 40.46 billion in calendar year 2014. The chart below provides the value of FPIs investments between calendar years 2006 to 2015:

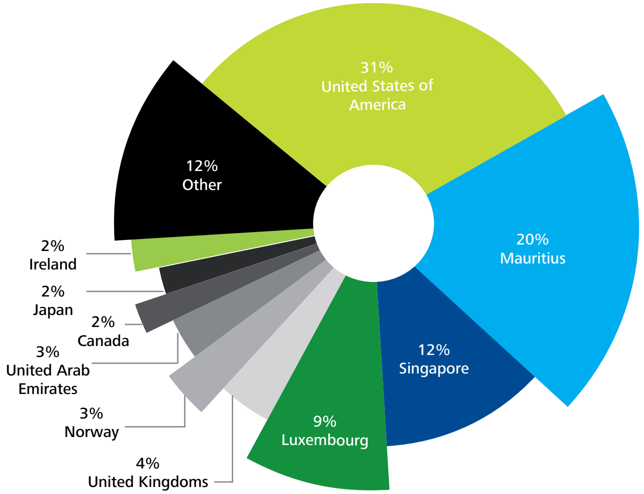


Source: NSDL, RBI

Source of FPI investments

USA continues to be the biggest source of FPI investments into India followed by Mauritius and Singapore. These three countries taken together account for over 70% of the total FPI investments into India. The below chart reflects the share of top 10 countries in the total Assets Under Custody (AUC) held by FPIs in India as 31 January 2016:

Total Assets under Custody US$ 324.24 Bn



Source: NSDL

Sector-wise investments

The sector-wise assets under custody of FPIs as on 31 January 2016 depicted below shows that the "Financial Services" sector is most favored by the FPIs followed by "Software & Services" and government debt.

Sr. No.	Sectors	Equity	Debt	Total
1	Financial Services	56160	7480	63640
2	Software & Services	37727	0	37727
3	Sovereign	0	25648	25648
4	Pharmaceuticals & Biotechnology	24423	0	24423
5	Automobiles & Auto Components	16709	40	16749
6	Oil & Gas	15012	33	15044
7	Capital Goods	13395	129	13524
8	Food, Beverages & Tobacco	12560	7	12567
9	Utilities	9060	1156	10216
10	Household & Personal Products	9675	0	9675
11	Others	78345	16683	95029
	Grand Total	273066	51176	324242

Debt investments

In order to maintain the attractiveness of Indian debt, the Government in the last year's budget had extended the concessional tax rate of 5% (plus surcharge and cess) on interest received by FPIs on government and corporate bonds to June 2017. Also, RBI announced a medium-term framework (MTF) for staggered increase in FPI limits in Government bonds including permitting FPI investment in State government securities. Through this staggered approach, the FPI limits will be increased to 5% of outstanding stock of central government securities and 2% of outstanding stock of state development loans by March 2018.

As per the debt utilisation status reflected on the National Securities Depository Limited (NSDL) website as of 25 February 2016, FPIs have utilized around 92% limits for central government securities (approx USD 24 billion) and around 57% limits for state development loans (approx USD 586 million). In the corporate bonds category, FPIs have utilized around 79% of the limits (approx USD 49.35 billion).

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