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BUDGET ANALYSIS

ECONOMIC INDICATORS 2016-17

February 2017

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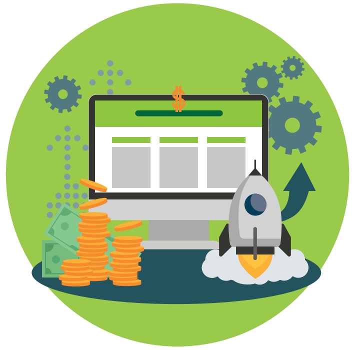
India continues to clock high growth rate despite demonetization and global slowdown



Economic Indicators

The Finance Minister of India presented the Economic Survey for the year 2016-17 in Parliament today. The key economic indicators relevant for FPIs are discussed below.

State of the Indian Economy

The Indian economy grew at a robust growth rate of 7.2% in the first six months (Apr'16 to Sep' 16) of the current fiscal year 2016-2017. As per the advanced estimates by the Central Statistics Office (CSO) the growth rate for second half (October 16 to March 17) is expected to be 7%. However, in the advanced estimates, the CSO has not considered the impact of the demonetization of high currency notes of INR 1000 and INR 500 announced by government on 8 November 2016. The government's stated objective for demonetization was to fight against corruption, black money, money laundering, terrorism and financing of terrorists as well as counterfeit notes. Considering that the high denomination notes accounted for 86% of the total notes in circulation and the fact that a major part of the economy runs on cash, the demonetization is bound to pull down the country's growth rate. As per estimates in the economic survey, the demonetization may slow down the country's growth rate by 0.25% to 0.5%. Nonetheless, India's growth rate for the full year 2016-17 would still be pretty impressive compared to the growth rate in the global economy in year 2016 which posted a growth of little over 3%.

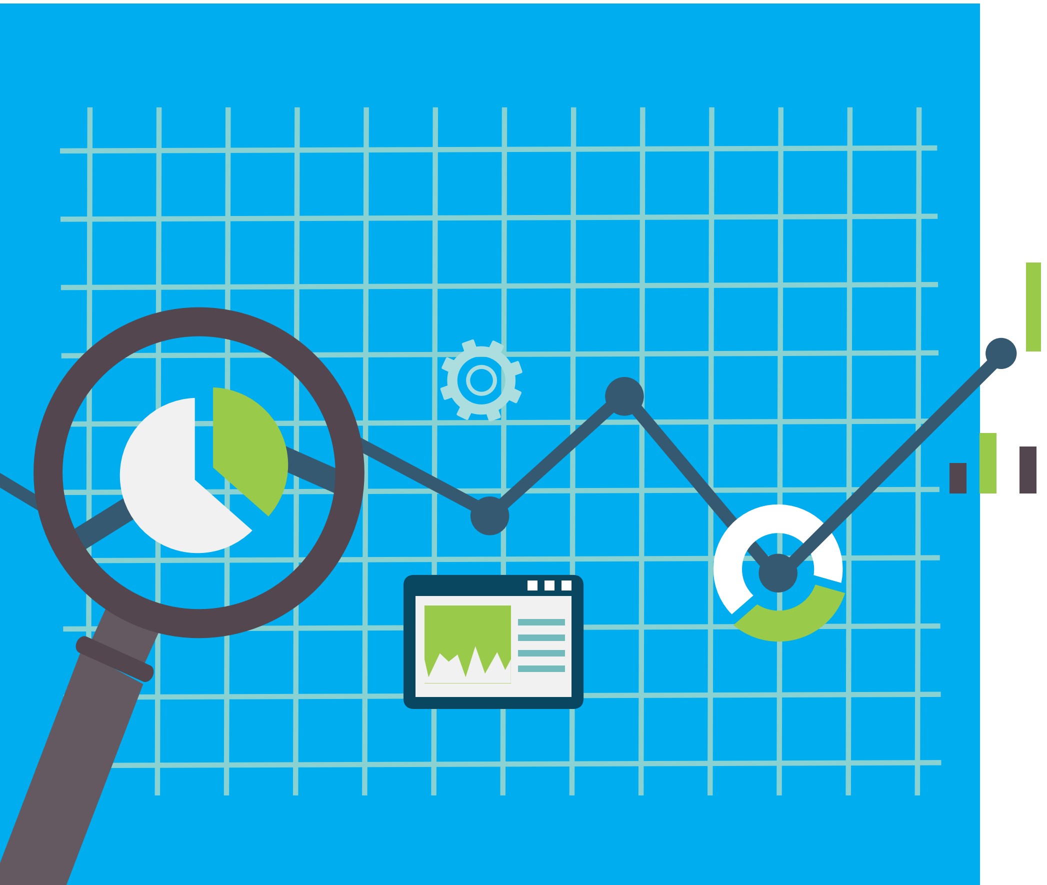
The consumer price inflation averaged 4.9% during April 2016 to December 2016 and declined to 3.4% at end of December 2016. The wholesale price inflation has reversed from the negative trajectory of -5.1% in August 2015 to 3.4% at the end of December 2016 primarily due to the rising international oil prices.

The current account deficit declined in the first half of the current fiscal to reach about 0.3% of the Gross Domestic Product (GDP). Despite the significant outflow of funds by FPIs in November and December 2016, the foreign exchange reserves were at comfortable levels of USD 360 billion at the end of December 2016. The fiscal deficit of the center as a percentage of GDP has been on a consistent declining trend and the central government is committed to achieving the fiscal deficit target of 3.5% of GDP in the current fiscal year.

The INR depreciated against USD by 3.4% during April 2016 to December 2016. The depreciation was largely post September 2016 on strengthening of the US dollar globally following the US presidential election results and tightening of monetary policy by the Federal Reserve. Further, INR has performed better than most of the other emerging market economies.

Overall, India continues to tread on a high growth path along with the robust macro-economic environment of moderate current account deficit coupled with broadly stable rupee-dollar exchange rate and fiscal consolidation.

One of the key challenges faced by the economy remains the low investment to GDP ratio owing to the stressed balance sheets in the corporate sector and the low savings rate. Additionally, the increase in crude oil prices and other commodities such as coal could result in inflation inching up and may adversely impact the country's trade and fiscal balances.



The key economic indicators for the financial year 2016-17 are:

Data categories	Unit	2013-14	2014-15	2015-16	2016-17
GDP and Related Indicators					
GDP Growth Rate	%	6.6	7.2	7.6	7.1[a]
Gross Value Addition (GVA) Growth Rate	%	6.3	7.1	7.2	7.0[a]
Capital Formation (rate)	% of GDP	34.7	34.2	29.3	27.7[b]
Prices					
Inflation Wholesale Price Index (WPI) (average)	%	6	2	-2.8	2.9[c]
Inflation Consumer price Index (CPI) (Combined average)	%	9.5	5.9	4.9	4.8[c]
External Sector					
Current Account Balance (CAB)/GDP	%	-1.7	-1.3	-1.1	-0.3[b]
Foreign Exchange Reserves	US$ billion	304.2	341.6	349.6	360[d]
Exchange Rate	INR /US$	60.51	61.14	66.32	67.95[e]
Money and Credit					
Broad Money (M3) (annual)	% change	13.4	10.8	11	10.3 [f]
Scheduled Commercial Bank Credit	% change	13.9	9	11.6	8.1[f]
Fiscal Indicators (Centre)					
Gross Fiscal Deficit	% of GDP	4.5	4.1	3.9	3.5 [a]
Revenue Deficit	% of GDP	3.2	2.9	2.5	2.3[a]
Primary Deficit	% of GDP	1.1	0.8	0.7	0.4 [a]

Notes:

a: Advance Estimate excluding demonetization impact

b: April, 2016 to September, 2016

c: April, 2016 to December, 2016

d: December, 2016 end

e: as on 30th December, 2016

f: as on 25th November, 2016

Monetary Management and Financial Intermediation

The government implemented two key monetary reforms in the year 2016 including setting up of inflationary targets by the government in consultation with the Reserve Bank of India (RBI) once in every five years and constitution of empowered Monetary Policy Committee (MPC) including members from RBI and outside experts. Under the revised monetary policy framework, the government has fixed the inflation target of 4 per cent with tolerance level of +/- 2 per cent for the period beginning from 5th August, 2016 to March 31, 2021. The MPC has had two meetings since its constitution on 29th September 2016. In its first meeting, MPC reduced the policy rate by 0.25 basis points to 6.25% but kept the rates unchanged in the second meeting while maintaining accommodative policy stance.

The short term Treasury bill (91 days) witnessed a steep fall in prices after the policy rate cut in April 2016. However, the 10 year government security yield continued to remain high and started falling since June 2016 and was at 6.63% as at the end of December 2016. The rate cuts by RBI since last year are yet to be effectively transmitted by the banks to clients.

The Non-Performing Assets (NPAs) of the banks, especially the public sector banks deteriorated further resulting in the net profit contracting in first half of the current financial year as compared to the corresponding period last year. The total gross NPAs to total advances ratio of all scheduled commercial banks taken together increased to 9.1% from 7.8% between March and September 2016.

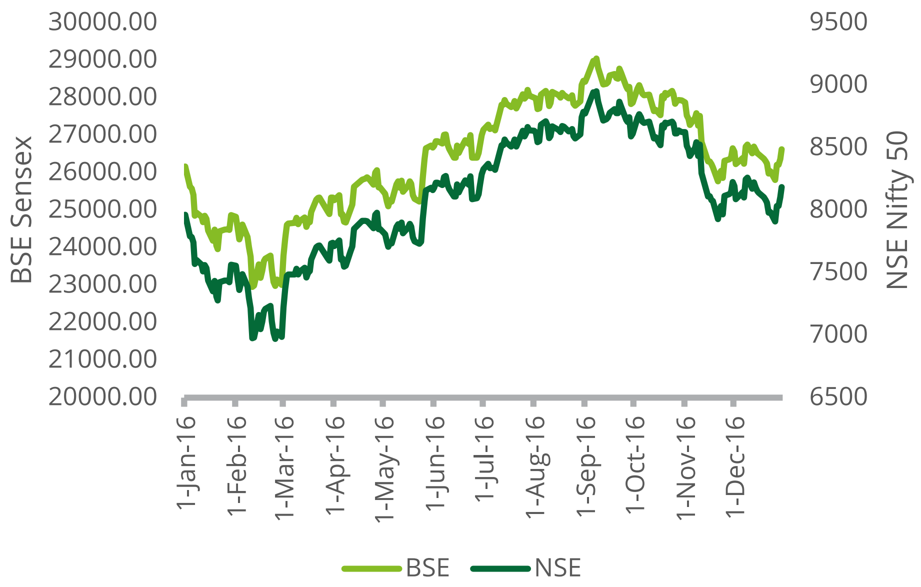
Measures to strengthen corporate bond market

RBI implemented a number of measures in the past year to boost the corporate bond market in India. The measures include a) permitting commercial banks to issue rupee-denominated bonds overseas (masala bonds); b) permitting SEBI registered brokers (which are authorized as market makers in corporate bond market) to undertake repo / reverse repo contracts in corporate debt securities; c) allowing banks to increase the partial credit enhancement they provide for corporate bonds to 50% from 20%; d) permitting primary dealers to act as market makers for government bonds; e) permitting hedging in over the counter (OTC) and exchange-traded currency derivatives to entities exposed to exchange rate risk up to a limit of USD 30 million at any given time.

Equity Markets

The Indian equity markets recorded modest growth in the calendar year 2016. While there was an upward momentum from March to September 2016, there was a sharp decline in the subsequent months believed to be caused by a number of developments including Brexit, demonetization in India, the US Presidential elections, policy announcement by the US Federal Reserve & RBI, policy decisions taken by the OPEC regarding oil production and the appointment of the new governor of the RBI.

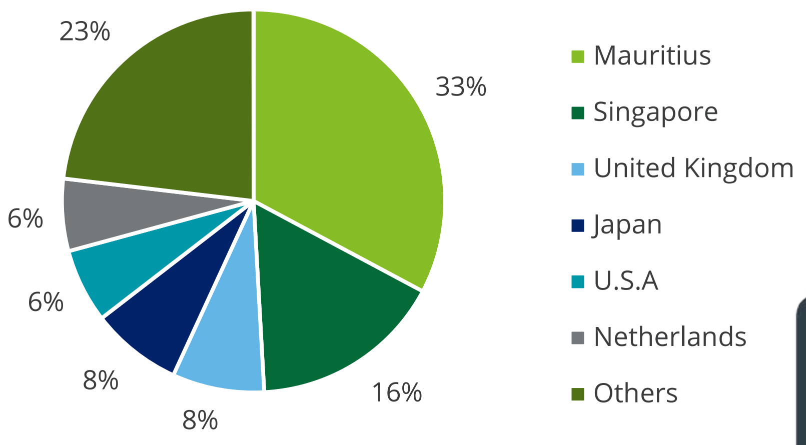
EQUTIY INDICES - SENSEX and NIFTY 50



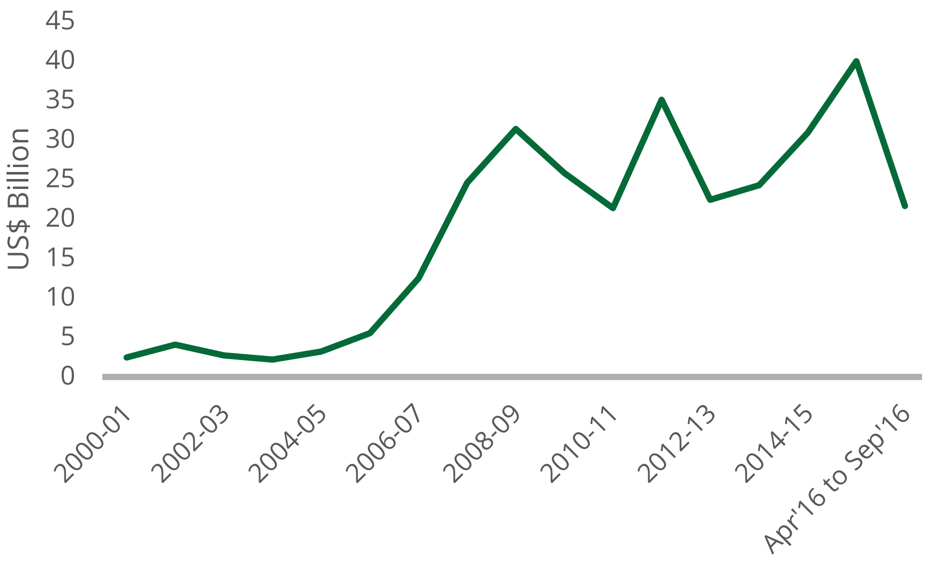
Foreign Direct Investments (FDI)

The government has further liberalized and simplified the FDI policy in various sectors including defence, railway infrastructure, construction and pharmaceuticals. The FDI investments in the first half of the current financial year (April 2016 to September 2016) were USD 21.7 billion as compared to total FDI inflows of US$ 16.6 billion during the corresponding period last year. Mauritius and Singapore continue to be the primary source of FDI investments into India accounting for 49% of the total FDI inflows in April to September 2016.

FDI inflows Apr'16 to Sep'16



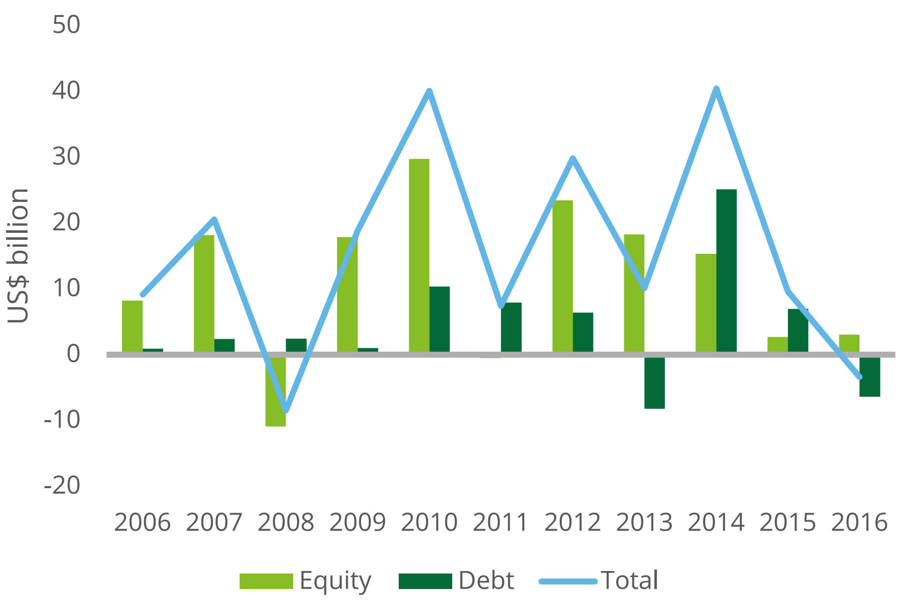
Financial year-wise FDI inflows



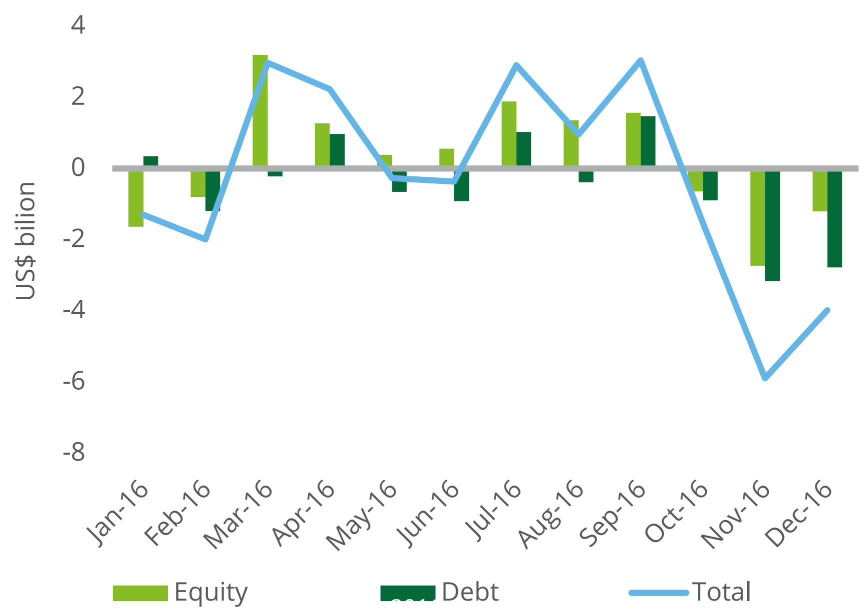
Foreign Portfolio Investors (FPI)

In the year 2016, while FPIs invested USD 3 billion on a net basis in equities. However, debt instruments registered a net outflow of USD 6 billion resulting in a net outflow of USD 3 billion at the aggregate level. The last two months of the year 2016 saw the largest net outflow of funds of almost USD 10 billion. The primary reasons behind this massive outflow of funds are believed to be Indian government's decisions to withdraw high denomination currency notes of INR 1000 and INR 500 from circulation (demonetization) on 8 November 2016, expectations of rate hike by US Federal Reserve and surprising outcome of US presidential elections.

Year-wise FPI Investments (net)



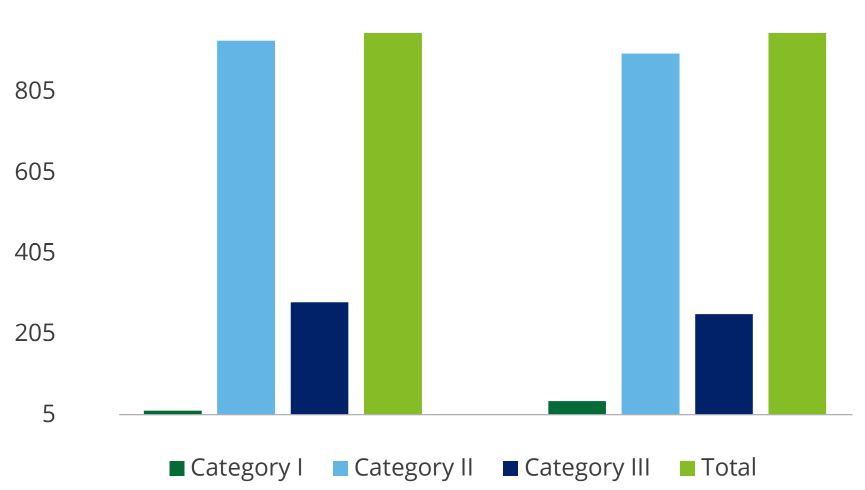
Month-wise FPI Investments (net) in 2016



Number of FPIs

The number of new FPI registration in year 2016 was 10% lower than the past year. Nonetheless, the number of new FPI registrations have consistently been on a healthy trend since the 2014 when Securities and Exchange Board of India replaced the erstwhile Foreign Institutional Investor (FII) regime with FPI regime.

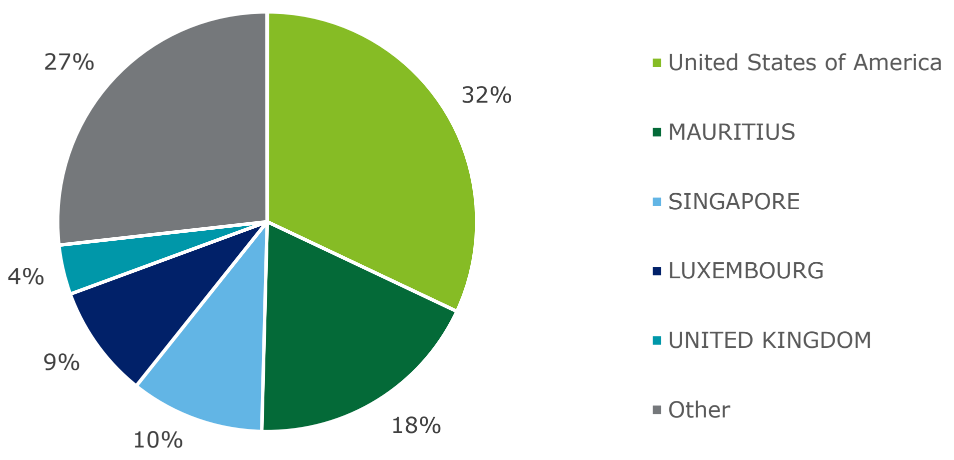
New FPI registrations



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 60% of the total FPI investments into India.

FPI Assets under Custody as on 31 Dec 2016: source country



Sector-wise investments

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

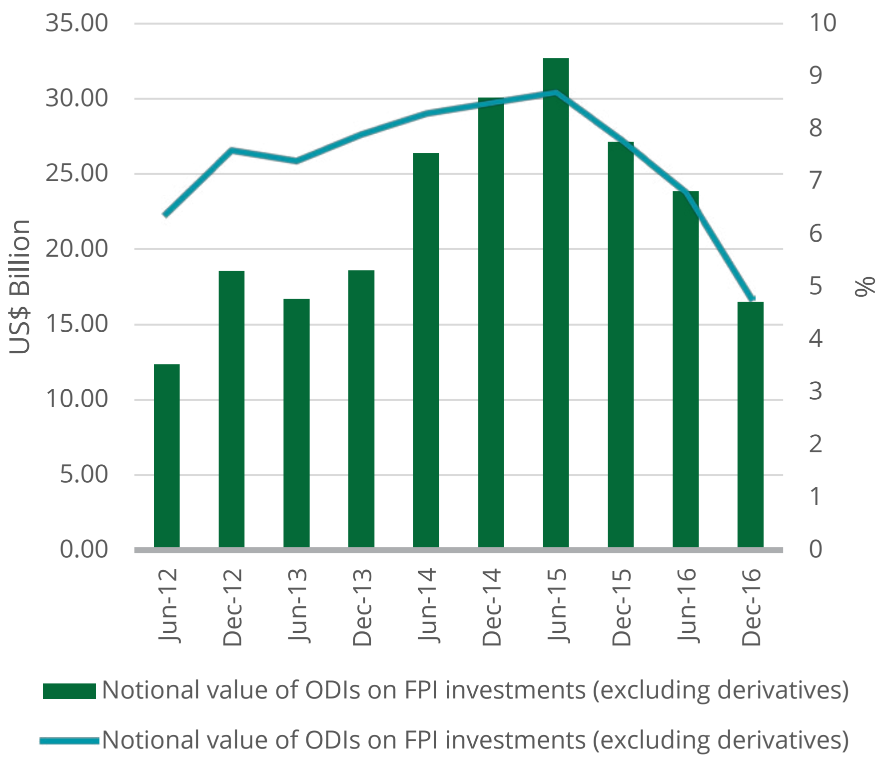
Sector-wise investments by FPIs (Asset under Custody as on December 31, 2016)

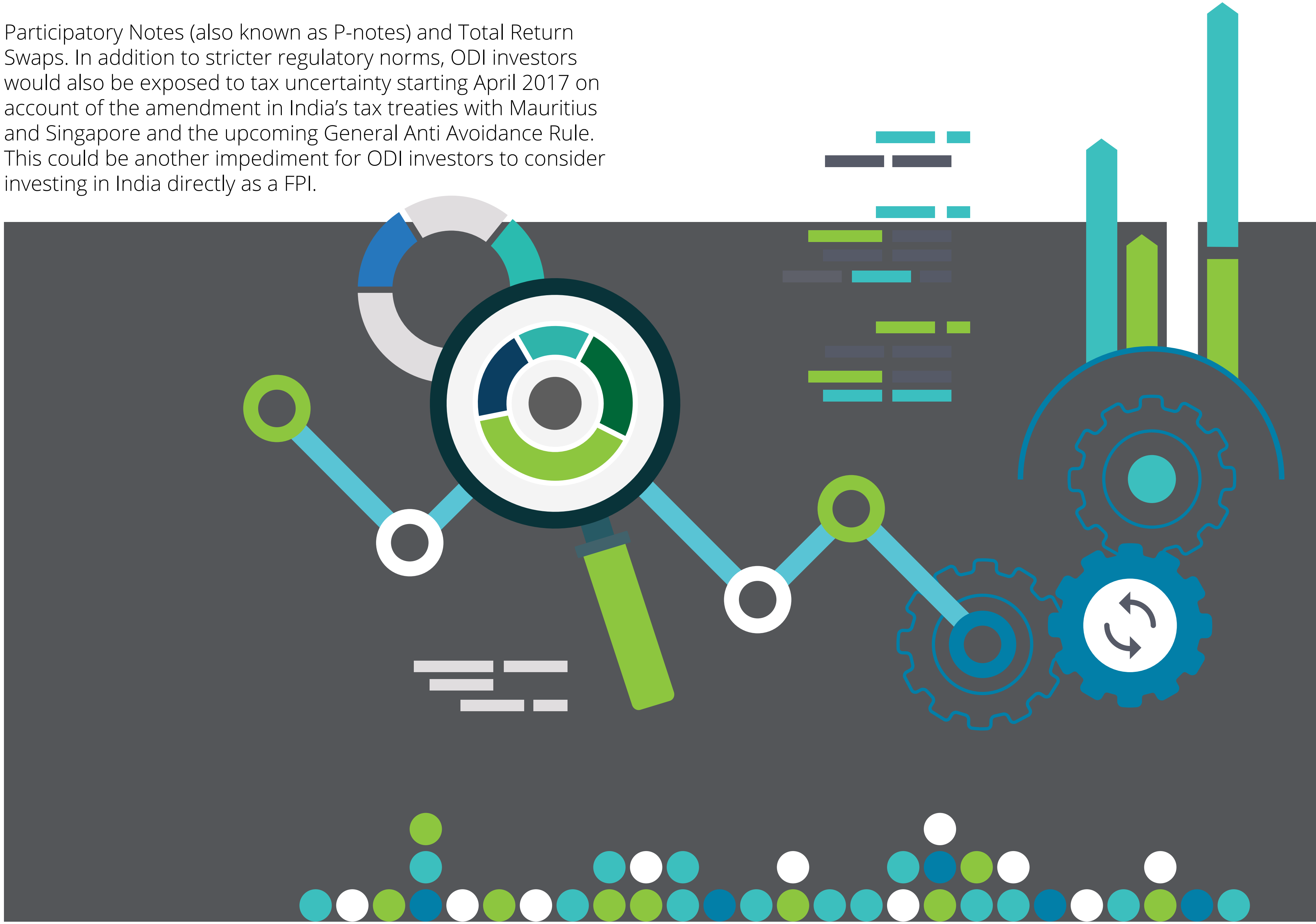
Sr. No.	Sectors	USD billion	%
1	Total Financial Services	68.409	20%
2	Software & Services	33.727	10%
3	Government debt	23.05	7%
4	Oil & Gas	20.224	6%
5	Automobiles & Auto Components	20.15	6%
6	Pharmaceuticals & Biotechnology	19.336	6%
7	Capital Goods	16.626	5%
8	Food, Beverages & Tobacco	13.066	4%
9	Utilities	12.214	4%
10	Household & Personal Products	10.23	3%
11	Others	108.493	31%
	Grand Total	**345.525**	**100%**

Contribution of ODIs in the FPI Assets under Custody

As a result of tightening of norms by SEBI, the share of Offshore Derivative Instruments (ODIs) to the total Assets under Custody of FPIs have declined from a high of 55.7% in June 2007 to 4.8% in December 2016. ODI is defined in the SEBI (FPI) Regulations, 2014 as any instrument issued overseas by a FPI against listed or to be listed Indian securities as the underlying. The popular form of ODIs issued against underlying Indian securities are Participatory Notes (also known as P-notes) and Total Return Swaps. In addition to stricter regulatory norms, ODI investors would also be exposed to tax uncertainty starting April 2017 on account of the amendment in India's tax treaties with Mauritius and Singapore and the upcoming General Anti Avoidance Rule. This could be another impediment for ODI investors to consider investing in India directly as a FPI.

Share of ODIs to FPI Assets under Custody





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