India – A step back to leap forward

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**Short term pains for long term gains**

### Short term (12-18 months)
- Likely to leave investors on a cautious footing
- US is India’s 2nd-largest trade partner after China
- Anti-outsourcing, revised visa policy could impact annual net inflows of c.2.5% of GDP

### Medium to long term
- Would depend on Trump’s policies
- There is an opportunity to improve trade relations with USA

### Uncertain global environment; more Fed rate hikes
- Impact on the economy

### Replacing 85% of currency in circulation
- 70% of customer’s transaction in India are settled in cash
- Rural, small and medium enterprise (SME) heavily cash reliant
- 50% of population unbanked

### Likely GST implementation
- Growth usually suffer in the first year of implementation (*cross country experience*)
- Less than ideal tax structure
- Less preparation time for corporate
- Federal structure in a large country

### Issues around counterfeit notes, terrorism
- Increased fiscal headroom on wider tax base to provide more space for investment
- Improved ease of doing business; better integrated markets
- Increased pace of financial inclusion, digitization to provide efficiency and growth gains

*Source: CEIC, Standard Chartered Research*
A year of uncertainties

<table>
<thead>
<tr>
<th>Uncertainties</th>
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<td>Trump’s policies</td>
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Brexit: From an event to reality

Upcoming elections in France, Germany

Protectionist policies; US-China relation

Source: Standard Chartered Research
60% of software exports are to US
(% of GDP, 2011-15 average)

Pharma can get impacted
% share of USD17bn exports by destination, FY16

*Since April 2000-March 2016; Source: IMF, Standard Chartered Research
INR view: Weaker but how much?

- Expect modest INR depreciation in 2017; end-2017 USD-INR forecast is 69 (Bloomberg consensus: 69). Risks to our call, however, are skewed towards a weaker INR.

- INR’s high carry and low vol characteristics make it one of the more attractive EM currencies.

- Low C/A deficit, low inflation, sufficient FX reserves suggest risks of abrupt INR weakness (like 2013) remain low.

- Higher crude oil prices, more aggressive Fed rate hike, one-off CNY devaluation are key risks to our forecasts.

Source: Standard Chartered Research
Currency replacement exercise: Impact varied across sectors

Some sectors held up well in the face of cash squeeze (y/y change in volume)

But some economic indicator showed signs of stress (% y/y change in volume except for PMIs)

Source: CEIC, Standard Chartered Research
Expectations were downgraded

New announcements fell sharply after demonetisation announcement on 8 Nov

<table>
<thead>
<tr>
<th>Period</th>
<th>Number of projects announced</th>
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<td>177</td>
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Nifty earnings downgraded by 4-5% led by banks, real estate

Consensus EPS revision post 8 Nov till 4 Jan

PUIs – Projects under implementation, Source: CMIE, Standard Chartered Research
GDP growth suffers in the first year of GST implementation

Cross country experience
% y/y

Large size of the economy, federal structure and mid year implementation can increase growth pains for India
Likely to further weigh on slow investment

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Moving average of incremental project value in the past four quarters , INR tn

PUIs – Projects under implementation, Source: CMIE, Standard Chartered Research
The existing headwinds unlikely to go in a hurry

NPAs are near at their highest level in a decade
NPAs + restructured loans as a % of total loans

Debt/equity and ICR (interest coverage ratio) for stressed sectors**, September 2016

- Textile
- Power
- Iron and steel
- Infra and construction
- Telecom

These five stressed sectors form over 60% of the bank total stressed assets

* Separate data for restructured assets not available before FY02
** Size of bubble indicates the relative size of the sector’s debt;
Source: RBI, Bloomberg, Standard Chartered Research
The GDP growth trajectory has shifted down

Consensus view on growth has been downgraded, *GDP growth, % y/y*

SCB forecasts are more conservative, % y/y

Source: Bloomberg, Standard Chartered Research
Growth outlook determines the pace of credit pick up

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<tr>
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<th>FY07</th>
<th>FY08</th>
<th>FY09</th>
<th>FY10</th>
<th>FY11</th>
<th>FY12</th>
<th>FY13</th>
<th>FY14</th>
<th>FY15</th>
<th>FY16</th>
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<tr>
<td>GDP growth annual</td>
<td>9.6</td>
<td>9.3</td>
<td>6.7</td>
<td>8.6</td>
<td>8.9</td>
<td>6.7</td>
<td>5.6</td>
<td>6.6</td>
<td>7.2</td>
<td>7.6</td>
<td>6.8</td>
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<tr>
<td>Credit growth</td>
<td>28.1</td>
<td>22.3</td>
<td>17.5</td>
<td>16.9</td>
<td>21.5</td>
<td>17</td>
<td>14.1</td>
<td>13.9</td>
<td>9.1</td>
<td>10.9</td>
<td>5.1</td>
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<td>Credit to industrial sector</td>
<td>26.7</td>
<td>25</td>
<td>23</td>
<td>24.4</td>
<td>23.6</td>
<td>20.3</td>
<td>15.1</td>
<td>13.1</td>
<td>5.6</td>
<td>2.7</td>
<td>-3</td>
</tr>
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</table>

Source: Standard Chartered Research
Inflation and policy rates: room for rate cuts

Core inflation to move higher; food inflation to remain contained (% y/y)

- We believe that slower growth, weak producer pricing power, lower demand pressures and a decline in real estate prices post remonetisation are likely to reduce price pressures in the economy.
- Some of the impact could be offset by higher global commodity prices especially crude oil.
- We expect CPI to average 4.5% y/y and 4.6% in FY17 and FY18 respectively.
- Despite the surprise pause by the RBI in Dec-16 meeting, we see a case for a further 50bps of rate cuts (in Feb-17 and April-17 policy meetings).
- Beyond that, the space for further policy easing would likely to be limited.

Source: CEIC, Bloomberg, Standard Chartered Research
Expectation of soft real estate prices can keep inflation under check

Real estate activity was already subdued (% y/y)

Quarterly launches and sales slowed post demonetization, # of units

Source: State budget documents, CEIC, Knight Frank (July-Dec 2016) Standard Chartered Research
Important not to lose sight of the big picture

Reforms necessary for longer-term gains

Incremental measures to yield results in medium to long term

Efforts are a move in the right direction, but more is required

Input reforms
- Legislative approval for GST
- Legislative approval of bankruptcy code
- Crackdown on black money; focus on financial inclusion
- Competitive federalism
- Monetary policy becomes operational
- Roads, railways and power-sector investment
- Ease of doing business; FDI liberalisation
- Progress on stalled projects
- Banking-sector measures

Source: Standard Chartered Research
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<th>SCB forecasts</th>
<th>FY15^</th>
<th>FY16</th>
<th>FY17F</th>
<th>FY18F</th>
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</thead>
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<tr>
<td>GDP growth, %</td>
<td>7.2</td>
<td>7.6</td>
<td>6.8</td>
<td>7.2</td>
</tr>
<tr>
<td>CPI inflation, %</td>
<td>6.0</td>
<td>4.9</td>
<td>4.5</td>
<td>4.6</td>
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<tr>
<td>Current account, % of GDP</td>
<td>-1.3</td>
<td>-1.0</td>
<td>-0.9</td>
<td>-1.7</td>
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<tr>
<td>Fiscal balance, % of GDP (central govt.)</td>
<td>-4.0</td>
<td>-3.9</td>
<td>-3.5</td>
<td>-3.0</td>
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<tr>
<td>10 Y bond yield, %</td>
<td>7.50</td>
<td>7.30</td>
<td>6.20</td>
<td>6.75</td>
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<tr>
<td>USD-INR (year-end)</td>
<td>63.30</td>
<td>66.25</td>
<td>68.25</td>
<td>69.00</td>
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