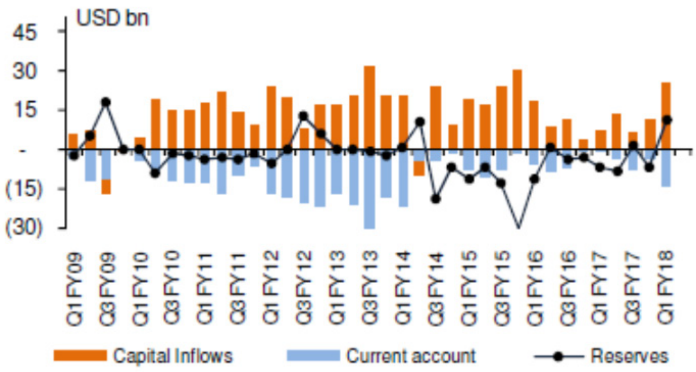
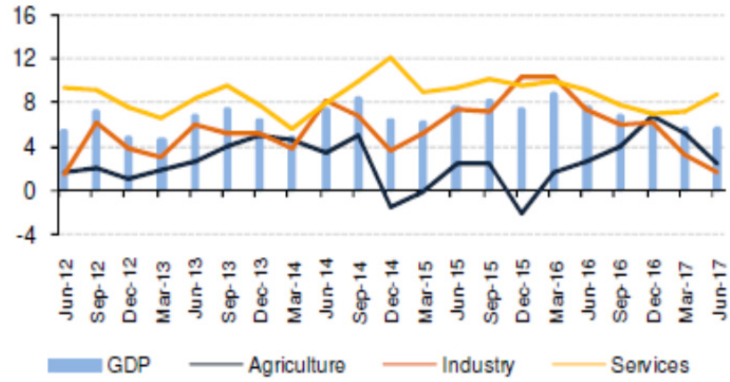
Monthly Political & Economic Updates
July to September 2017

India Balance of Payments



Source: CSO, UTI MF Research

India's Real GDP (Activity-wise)



Source: CSO, UTI MF Research

1. **India's landmark tax reform – the Goods & Services Tax (GST) rocks headlines on 1 July**
   On 1 July, the much-awaited GST was officially rolled out. The GST comprises a tiered rate structure across various sectors and replaces all other taxes at the state / central level. The standardisation of taxes marks the biggest reform in the country's tax regime. Whilst IT infrastructure will need time to adopt and support the implementation, long term benefits of the GST include:
   - Addition to tax revenues which could add up to 40bps to GDP
   - Controlled inflation
   - Improved fiscal balances over the long term

2. **Reserve Bank of India (RBI) cuts rates in its August monetary policy review**
   The Monetary Policy Committee (MPC) voted 5-1 in favour of reducing the policy repo rate by 25 basis points from 6.25% to 6.00%, which was in line with market expectations. MPC members highlighted near-term downside risks to growth (especially given the temporary effects of demonetization) and concerns over fiscal slippage. The RBI therefore utilized this window to ease policy before the inflation trajectory picks up going forward, and maintained its neutral policy stance

3. **RBI adjusts consumer price inflation (CPI) forecasts, maintains growth estimates**
   RBI highlighted some upside risks to inflation after low base effects. Primary factors for upside risk include the recent uptick in select vegetable prices, farm loan waivers, revised tax rates after GST implementation and the 7th Pay Commission salary and allowance revisions which will get implemented across states. However, upticks will remain manageable due to moderating factors such as a favourable monsoon, stable core inflation and stable global commodity prices. CPI projections for H2 FY18 stand at 3.5-4.5% (still within the RBI's comfort band). Meanwhile GVA growth forecast (Gross Value Add) for FY18 was retained at 7.3%

4. **GDP growth for Q1 FY18 slows to lowest in 4 years reflecting temporary factors**
   First quarter (April-June) GDP growth slowed to 5.7% year-on-year due primarily to two reasons: (1) the impact of demonetization which provided a temporary shock to the economy; (2) GST implementation. Industrial demand has weakened ahead of GST uncertainty as the new tax rates structure has yet to be absorbed across all sectors. Going forward, growth is likely to be driven by consumption. Furthermore, since demonetization, the Central Board of Direct Taxes already reported a 24.7% rise in filed income tax returns from April - August, versus the same period over the previous year. IMF retained India's GDP annual growth projections at above 7% for FY18.

5. **India's Balance of Payments sees huge capital flows, $11bn added to FX reserves**
   Q1 FY18 external balances were supported by capital flows. The financial account witnessed a surge in both FDI (foreign direct investment) and FII (foreign institutional investor) flows. FDI at 7.2 billion was 89% higher than in Q4 FY17. Moody's said India is likely to see increased FDI inflows on the back of reforms such as introduction of the goods and services tax and the bankruptcy code. Meanwhile FPI reflected inflows in both equity ($0.7 billion) and debt ($11.2 billion). The stable India macro story, declining inflation readings during Q1 and a stronger INR led to robust debt inflows. Although the current account deficit (CAD) widened to a four-year high due to a higher import bill, Q1 FY18 saw an accretion of $11.4 billion to FX reserves versus $7.3 billion the previous quarter. The CAD funding is expected to improve once again given healthy FDI flows and positive transmission of announced reforms on growth inflation dynamics.

6. **Union Cabinet approves setting up of an alternative mechanism for merger of public sector banks**
   Moody's deemed this move as positive, stating that merging India's public-sector banks will improve their ratings because of efficiencies of scale and improved corporate governance. Moody's added that its outlook for the Indian banking system is stable on improved prospects for asset quality

7. **RBI creates headroom within corporate bond limits for FPIs by shifting masala bonds to the ECB category**
   With effect from 3 October 2017, the RBI announced that Masala Bonds will no longer form a part of the corporate bond investment limit for FPIs. Instead, they will form a part of the ECBs (external commercial borrowings) and be monitored accordingly. Essentially, this creates room for FPI investment and releases limits in the corporate category worth INR 44,001 Crores (approx. $6.7 billion). This will be made available for FPI investors over the next two quarters. (Note: Masala bonds are Indian rupee denominated bonds but issued in overseas exchanges. This move comes after corporate bond limits for foreign investors have exceeded the 95% mark).