Atradius Country Report

India – November 2011

Overview

General information

Capital:	New Delhi
Government type:	Federal republic
Currency:	Indian rupee (INR)
Population:	1.2 billion
Status:	Lower middle income country (GDP/capita: US$ 1,643 in 2011)

Most important sectors (% of GDP, 2010)

Services:	55 %
Industry:	29 %
Agriculture:	16 %

Main import sources (2009, % of total)

China:	11.8 %
UAE:	7.4 %
USA:	6.0 %
Saudi Arabia:	5.4 %
Australia:	4.5 %

Main export markets (2009, % of total)

UAE:	14.4 %
USA:	10.8 %
China:	5.9 %
Hong Kong:	4.1 %
Singapore:	3.9 %

Main expenses of foreign exchange

Import of petroleum products (32 %), electronics (10 %), capital goods (11 %), gold & silver (9 %), machinery (8 %)

Main sources of foreign exchange

Engineering products (23 %), petroleum products (15 %), textiles (14 %), gems (14 %)

Key indicators

	2008	2009	2010	2011*	2012*
GDP (US$ million)	1,283,208	1,353,214	1,722,360	1,975,082	2,318,521
Real GDP growth (%)	5.1	9.1	8.8	7.9	8.4
GDP per capita (US$)	1,118	1,161	1,455	1,643	1,900
Inflation p.a. (%)	8.4	10.9	12.0	7.2	5.1
Fiscal balance (% of GDP)	-6.0	-6.1	-5.0	-4.7	-4.7
Total foreign debt (US$ million)	224,712	237,691	251,836	267,460	277,978
Foreign debt/GDP (%)	18	18	15	14	12
Foreign debt/XGS (%)	71	87	70	60	55
Short-term debt/inter. reserves (%)	18	16	21	20	19
Debt service ratio (%)	10	6	10	8	7
Current account balance (US$ m.)	-32,298	-26,690	-51,875	-68,887	-60,587
Current account/GDP (%)	-2.5	-2.0	-3.0	-3.5	-2.6
Nom. exchange rate to US$ (average)	44.0	48.0	46.0	44.6	43.4
International reserves (US$ million)	247,419	265,182	275,277	326,404	360,773
In months of merchandise imports	15	12	9	8	8

*forecast   Source: Economist Intelligence Unit (EIU), International Monetary Fund (IMF)

Political situation: Fairly stable

Head of state:	President Pratibha Patil (since 25. July 2007)
Head of government:	Prime Minister Manmohan Singh (since 22. May 2004)
Form of government:	A 5 party coalition government of the United Progressive Alliance (UPA), led by the Indian National Congress (INC). Main opposition party is the Hindu-nationalist BJP

Internal: several corruption scandals have shaken the government

The coalition parties of the United Progressive Alliance (UPA) received a boost in the May 2009 general election, gaining 262 of the 543 seats (48 %) in the Lok Sabha (lower house). Before the election, the UPA minority government had to rely on the support of Communist regional parties to secure a parliamentary majority. This made governing unwieldy and often led to uneasy compromises, impeding comprehensive economic reforms. With its electoral gains of 80 seats (mainly for the Indian National Congress Party), the administration is more cohesive, albeit that the coalition government remains dependent on the support of smaller parties outside the UPA.

The opposition coalition, National Democratic Alliance is led by the rival BJP. This coalition controls only 159 seats, and the BJP is internally divided between Hindu nationalists and secular centre-right factions, making its comeback less likely in the short term.

However, several corruption scandals have recently shaken the government and hampered parliamentary processes and progress. The October 2010 commonwealth games were overshadowed by massive corruption and mismanagement allegations. In November 2010, Telecommunication minister A. Raja was accused of deliberately underselling 2G mobile phone licences, instead of auctioning them, in exchange for bribery payments, causing the loss of state revenues worth several billion US$. This has put increasing pressure on prime minister Singh and led to temporary blockades of parliamentary business by the opposition. In March this year, indications surfaced of vote buying by the Congress Party, putting additional pressure on Singh and his government.

Despite several violent conflicts (tensions between Hindus and Moslems in Kashmir, and more than 20,000 Naxalites-Maoist rebels active in the rural areas of several central and eastern states) India as a whole is still regarded as a fairly stable nation and a successful emerging economy.

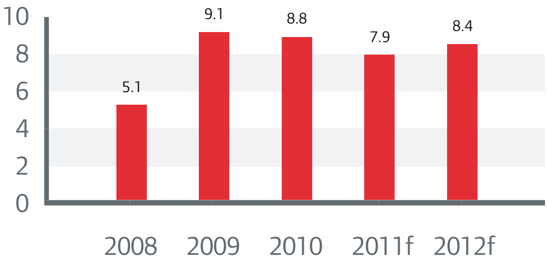
International: relations with Pakistan remain strained

The Mumbai terrorist attacks in November 2008 proved a serious setback to relations between India and Pakistan. New Delhi immediately withdrew from the peace talks that had begun in 2004 with the aim of settling outstanding disputes such as the Kashmir conflict, and demanded that Pakistan bring to justice those responsible for the attack and dismantle the terrorist networks. After some efforts by Pakistan to comply in principle, both prime ministers met in private at an international conference in July 2009 to discuss the resumption of bilateral peace talks, but could not agree. Unofficial bilateral meetings by senior officials have been resumed, but relations remain strained and may well deteriorate again.

Relations with China remain sensitive, due in part to border disputes. However, economic ties are improving. After decades of rather lukewarm relations with the US, Washington now considers India a strategic partner and potential counterbalance to China's rising power in Asia.

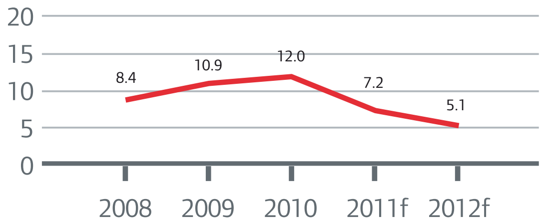
Internal economic situation: Slightly decreasing growth

Real GDP growth (%)



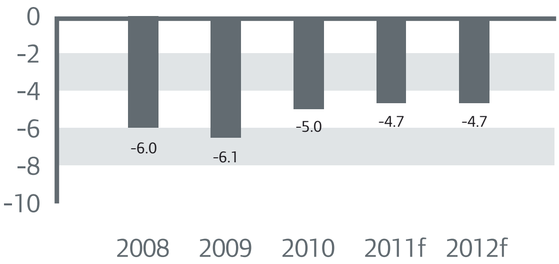
Source: EIU/IMF

Inflation p.a. (%)



Source: EIU/IMF

Fiscal balance (% of GDP)



Source: EIU/IMF

Decreasing, but still high growth rates

The Indian economy had achieved high growth rates of more than 7 % each year since 2003, peaking at 9.7 % in 2006. Only in 2008 did output slip - to 5.1 % - due to the bursting of the domestic shares and other asset bubbles in the wake of the global economic crisis. In contrast to other Asian emerging markets, India's economy is driven mainly by domestic consumption, with exports accounting for only 21 % of GDP. The external sector has traditionally been dominated by services: especially information and communication technology (ICT), and business service outsourcing.

Real GDP growth stood at 8.8 % last year, driven by the booming services and manufacturing sectors and private consumption. However, a moderate decrease is currently taking place this year (GDP growth slowed to 7.7 % year-on-year in Q2) and will continue in the coming months, as the global economy weakens and interest rates remain high. Overall economic growth is forecast to slow to 7.9 % in 2011. Business confidence shows a decreasing trend since April and manufacturing output growth is also slowing.

Inflation remains the major concern

Consumer price inflation was 12 % in 2010 as food prices rose sharply and prices for capital goods, shares and real estate also tended to increase rapidly. Fuel price increases have contributed to the overall price inflation as has the inability of the supply capacity of the Indian economy to keep pace with demand.

While inflation has decreased somewhat since January 2011, it nevertheless remains quite high (9 % in September), and the upward pressure on price levels will continue for the time being. Therefore, high consumer prices remain a serious concern, undermining the purchasing power of the many poorer households (according to World Bank estimations more than three quarters of the populations still live on less than US$ 2 a day). Food inflation, which accounts for over 14 % of overall Wholesale Price Index (WPI) inflation, has remained high since December 2010, despite good harvests, indicating that the price level is driven even more by structural bottlenecks.

To curb inflation, the Reserve Bank of India (RBI) has tightened monetary policy by repeatedly raising key short-term interest rates (repo rates): by 350 basis points since March 2010. In September this year, the RBI again increased interest rates: by 25 basis points to 8.25 %, and further increases are anticipated. This is in contrast to some other emerging markets that have recently lowered interest rates as a reaction to the Eurozone debt crisis and faltering US economy.

High budget deficits persist

The government's poor budgetary discipline is reflected in persistent budget deficits. The central budget deficit is 5 % of GDP for 2010 and 4.7 % of GDP for 2011, but the total deficit, including those of the federal states, amounts to 10 % of GDP according to the IMF. The main reason is the low tax base, combined with high expenditure on subsidies for fuel, food and fertilizer. While these deficits can be financed by domestic borrowing, that has pushed domestic public debt as high as 70 % of GDP in 2010.

Major structural deficiencies, but only slow reform progress

Beside the high budget deficit, India's main structural deficiencies are: the underdevelopment of the agricultural sector; poor infrastructure; inflexible labour laws; excessive bureaucracy; rigid land laws (Land Acquisition Act), and a shortage of skilled labour due to the poor education of most of the population.

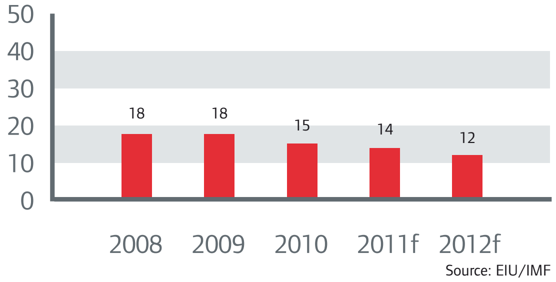
Many expected that, after its success in the 2009 general election, the Congress party would finally tackle the necessary structural reforms that it had been unable to pass in its first term due to its dependence on support from left-wing parties. Although the government has launched some initiatives to fight rural poverty and to cut fuel subsidies, the prospects for significant structural reforms remain bleak: it still does not command a parliamentary majority, the political landscape remains fragmented, and there are strong anti-reform forces within the Congress Party.

Energy situation: dependence on oil imports is a major weakness

India is the world's largest producer of coal, which provides more than 50 % of its energy consumption. 66 % of oil and gas is imported. Electricity supply is highly unreliable, representing a major impediment for the economy. The high dependence on oil imports and the high subsidies associated with it are the Achilles´ heel of the Indian economy.

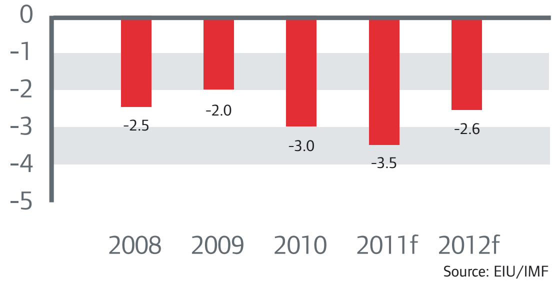
External economic situation: Good solvency and liquidity situation

Foreign debt/GDP (%)



Source: EIU/IMF

Current account/GDP (%)



Source: EIU/IMF

Foreign debt

Level:	Low (14% of GDP and 60 % of exports of goods and services in 2011)
Structure:	Favourable (75 % long term in 2011)
Debt service ratio:	Low (8 %), but fairly high (21 %) including short-term debt

Remarks:
While foreign debt is low, total public sector debt is fairly high: at 70 % of GDP.

Balance of payments

Trade balance:	Structural deficits
Current account:	Small deficits since 2006 (2011: 3.5 % of GDP)
Capital account:	Structurally positive
Total account:	Structurally positive

Remarks:
India remains a relatively closed economy (export of goods and services amount to 21 % of GDP). Trade balance deficits are largely balanced by surpluses on service and transfer account. Foreign capital inflows consist largely of portfolio investment.

International reserves

In months of imports (cif):	Good, 8 months of import cover in 2010. However, liquidity has decreases over the last couple of years.

Outlook: Moderate growth decrease, but good long-term prospects

Corruption charges continue to weaken the government

Several corruption scandals have undermined the government's authority, making the building of parliamentary alliances to achieve majorities even more difficult. Therefore, further progress in structural reform is unlikely in the short term. The next general elections are scheduled for 2014, but an early election cannot be entirely ruled out.

Growth will remain comparatively high in 2012

Although forecasts have been revised downwards, economic growth will remain high in an international context (8.4 % in 2012). Inflation is expected to slow down next year. The sustainable foreign debt level, high reserves and prudent foreign debt management will continue to underpin India's sovereign payment capacity.

Still a long way to go

As a lower-middle income country, India still has a long way to go in terms of development. Welfare is unequally distributed among regions and social groups, but a middle class that is able to sustain a buoyant domestic market is growing rapidly, creating increasing demand for consumer goods and opportunities for domestic and foreign investment.

Moreover, the economic structure has to be significantly upgraded, especially with regard to India's poor infrastructure. The issues of power supply, roads and railways, and the poor education system urgently need to be addressed. More public/private investment partnerships for infrastructure projects are needed, and the government plans to increase incentives for private investors. So far, private sector participation in infrastructure development has been concentrated mainly in the telecoms sector, with such participation in other areas (sanitation, power generation, roads and railways) much lower than expected. Consequently, there is a continuing problem of power and water shortages in all India's major cities. The government is still deferring major structural reforms to stimulate FDI, i.e. to allow foreign investment in the retail sector.

India's growth profile, in contrast to that of China, is reflected in a substantial 'twin deficit': both the public sector account and the current account registering negative figures. India's public sector deficit adds to the government debt, which reached 70 % of GDP in 2010. Fiscal discipline in India is quite poor, based on low tax revenues and the extensive programme of subsidies on food, fuel and fertilizers. Although the current account is structurally negative, ample international liquidity and a low level of external debt ensure that India will continue to be a fast-growing and robust market.

Trading with Indian companies

General characteristics

- Financial data is available for large corporations and larger mid-size companies. It can be difficult to get hold of financial data for smaller companies – particularly partnerships and sole proprietorships.

- Traditionally, Indian business houses show only marginal profits, to avoid taxation. The real profitability of Indian companies is often far higher than that revealed in the balance sheet. Understanding the private wealth and standing of company owners and managers can be important when assessing credit risk in India.

- Atradius uses a variety of sources to check companies standing, including information suppliers, the internet and local partners. We may also ask a company's customers to assist us where we draw a blank, as supportive trading experience can be useful..

- Insolvencies are uncommon. Winding up a company by petition can take a very long time, so is very much a last resort for recovery of debt.

General trade terms

- Open account trade is the norm – 60/90 day terms are prevalent for export transactions into India.

- Letters of Credit are rare except for large value contracts with state or state-owned entities. If they are used, great care should be taken in presenting the documents in exactly the correct form as otherwise the buyer may exploit any discrepancy by delaying payment.

- Retention of Title is not common in India and, even if specifically stipulated on the invoice, is legally very difficult to enforce.

- Post dated cheques are common in domestic trade transactions. The Indian law takes cheque fraud seriously - it can lead to criminal action. This tool is most effective if the cheque is signed by the company proprietor.