THE WORLD IS NO LONGER FLAT

Jahangir Aziz
(91) 22-6157-3385
jahangir.x.aziz@jpmorgan.com

Gunjan Gulati
(91) 22-6157-3386
gunjan.x.gulati@jpmorgan.com
Global economy bouncing to malaise

- A powerful synchronized global upturn as inventory and durables rebound and trade normalizes

- Growth sustainability depends on:
  - firm and household behaviour shifting from retrenchment to expansion
  - managing the permanent decline in DM potential GDP
  - withstanding prolonged fiscal headwind
Global IP surges

Global growth
%q/q, saar

Industrial production
%oya, 3mma

Quarterly

year-on-year

Asia

Lat AM

East EUR

Developed Mkts

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And trade recovers
Global risk I: premature tightening

Developed Markets
- Policy rate
- Inflation
- Growth

Emerging Markets
- Policy rate
- Inflation
- Growth
Global risk II: DM saving keeps rising

US personal saving rate
% of disposable income, sa

Households saving rate
percent, sa

Germany
UK
Should we be comforted …

**EM consumes more than the US now**

% of global consumer spending

**With lower consumption propensity**

% of GDP

- EM consumes more than the US now
- With lower consumption propensity
Global private consumption

Global investment

... or concerned?
Global risk III: Fiscal headwind and social cost of unemployment rising

Developed world unemployment rates

% of GDP, both scales

Deficit
Debt

DM fiscal deficits and debt
Global risk III: Profit margins have surged, wages haven’t
India turns hot as demand indicators surge

IP and PMI
Jan 2005=100
New orders/finished goods

Orders-to-inventory
IP

Motor vehicle sales
%oya, 3mma, both scales

CV sales
Passenger car sales
Capacity may begin to get constrained

**Capital goods drive the strength**

*Index sa, Sep 2008=100*

- Intermediate goods
- Basic materials
- Capital

**Durables gain on motor vehicle sales**

*Index sa, Sep 2008=100*

- Durables
- Nondurables

Durables gain on motor vehicle sales
Credit languishes as investment is flat

Inv growth has fallen below 03-08 avg

Credit depends on investment

Nominal credit

Nominal investment
A lot depends on the global economy for IP, growth,
... and even inflation

Inflation and exports

%oya, 3mma both scales

Exports

WPI

Mar-01 Mar-03 Mar-05 Mar-07 Mar-09

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15
Monetary tightening started earlier than January
Output gap could close soon

GDP growth and output gap

- GDP growth
- Potential growth
- Output gap
Food inflation not credit dependent, but core is and it is rising.

Food inflation moderates, bigger worry is non-food.

Previous tightening

Food

Non-food
Policy stance

- Move to neutral from easy conditions quickly
- Hold at neutral until global uncertainty and domestic inflation path clarifies
- Tighten if inflationary pressures persist
- Loosen if global growth falters
- If position still easy in 2H10 and inflation picks up, tightening would have to be too aggressive (remember Jul-Aug 08) raising the spectre of a hard landing
Despite CRR hikes liquidity remains above normal

Call and Policy Rates

Rs bn both scales

- Call rate above upper band
- Easy liquidity
- Tight liquidity
Market underestimating the speed of policy hikes

Market pricing too little near term policy rate hike

OIS-reverse repo rate, in %
# How much more tightening?

## Unpleasant Monetary Arithmetic

<table>
<thead>
<tr>
<th>Call Rate</th>
<th>Expected Inflation</th>
<th>Real policy rate</th>
<th>Expected growth</th>
<th>Growth-interest gap</th>
<th>Monetary condition</th>
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<tbody>
<tr>
<td>Sep-07</td>
<td>6.5</td>
<td>5.0</td>
<td>1.5</td>
<td>9.0</td>
<td>7.5 Neutral</td>
</tr>
<tr>
<td>Sep-08</td>
<td>5.8</td>
<td>7.0</td>
<td>-1.3</td>
<td>8.0</td>
<td>9.3 Loose</td>
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<tr>
<td>Mar-09</td>
<td>3.3</td>
<td>4.0</td>
<td>-0.8</td>
<td>6.0</td>
<td>6.8 Tight</td>
</tr>
<tr>
<td>Mar-10</td>
<td>3.3</td>
<td>6.0</td>
<td>-2.8</td>
<td>8.0</td>
<td>10.8 Loose</td>
</tr>
<tr>
<td></td>
<td>6.5</td>
<td>6.0</td>
<td>0.5</td>
<td>8.0</td>
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</tr>
</tbody>
</table>
Budget still pro growth

Less stimulus withdrawal than meets the eye

% GDP

Deficit
Deficit - asset sales + offbudget bonds

Stimulus

FY99 FY00 FY01 FY02 FY03 FY04 FY05 FY06 FY07 FY08 FY09 FY10 FY11

Less stimulus withdrawal than meets the eye

The world is no longer flat
## Financing risky

### Recent deficit drivers

Rs bn, fiscal years beginning April 1

<table>
<thead>
<tr>
<th></th>
<th>FY09</th>
<th>FY10</th>
<th>FY11</th>
<th>FY11-FY10</th>
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<tbody>
<tr>
<td><strong>Net borrowing</strong></td>
<td>2336</td>
<td>3984</td>
<td>3450</td>
<td>-534</td>
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<tr>
<td>Disinvestment</td>
<td>6</td>
<td>260</td>
<td>400</td>
<td>140</td>
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<tr>
<td>Other capital receipts</td>
<td>340</td>
<td>368</td>
<td>746</td>
<td>378</td>
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<tr>
<td>Oil subsidies</td>
<td>788</td>
<td>253</td>
<td>31</td>
<td>-222</td>
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<tr>
<td>Fertilizer subsidies</td>
<td>958</td>
<td>530</td>
<td>500</td>
<td>-30</td>
</tr>
</tbody>
</table>
Lower deficit in not anti-growth

Borrowing drives lending rates

Lending rate is a key driver of growth

1 yr lagged PLR

%oya, inverted axis

Borrowing (2Y avg)

Real PLR

Real GDP

Real GDP

Borrowing (2Y avg)

Real PLR
Budget financing need assurance

- Early 3G sales
- Early PSU disinvestment
- Early oil pricing reform
INR appreciation likely once global risk abates

FII will drive INR... unless oil price spikes

USD/INR, inverted axis

Spot INR

Crude oil
Exchange rate policy still biased towards nominal undervaluation

NEER has trended down 15%

REER has trended up 15%
But FX management has improved lately

RBI intervention has reduced sharply

USD bn

Jun- Dec- Jun- Dec- Jun- Dec- Jun- Dec- Jun- Dec-
06 06 07 07 08 08 09 09

-19 -14 -9 -4 1 6 11
Going the China way?

China: GDP by expenditure

% of GDP

- Private consumption
- Net exports
- Fixed investment

India: GDP by expenditure

%GDP

- Consumption
- Net exports
- Investment

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Going the China way?

Inflation and exports
%oya, 3mma both scales

Exports

Inflation

Inflation and exports
%oya, 3mma

Exports

Inflation
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