

Political

General Political Environment: The United Progressive Alliance (UPA) led by the Indian National Congress (Congress) was re-elected to a second five year term in 2009. The UPA succeeded in gaining a stronger electoral mandate in 2009 and therefore has had to rely less on left leaning coalition partners in contrast to the coalition formed in 2004. The UPA coalition's victory wasn't overly surprising; however, the margin of its victory was astonishing. The opposition coalition led by the Bharatiya Janata Party (BJP) finished a distant second.

In the lead up to the 2009 elections India watchers were predicting a strong showing on the part of regional parties at the expense of national parties; this did not occur. The rise in prominence of regional parties (i.e. parties with a political presence in fewer than four states) has been one of the most significant political developments to occur in contemporary India, with over 30 political parties represented in Parliament. Although regional parties will remain essential in India's multi-party coalition politics, the 2009 election results reflect the continued prominence of national parties, namely Congress.

In December 2009 the Indian government announced plans to establish a new state – Telangana – which would be carved out of the state of Andhra Pradesh. Many of India's 28 states are made of up disparate ethnic and linguistic groups and the proposal to create Telangana is a bid towards granting significant groups their own state. The Telangana issue is highly contentious as it will likely lead to increased demands for the creation of other states throughout India.

Investment Environment: Despite India's foreign investment policy allowing 100% FDI in most sectors, India has thus far failed to reach its full potential as a destination for FDI. The government's attempts at increasing FDI inflows have been hampered by several impediments including pervasive corruption, an unwieldy bureaucracy, and a critical infrastructure deficit. India is known for diverse operating environments with regulations varying from state to state.

Significant reform in investment-related matters was delayed over the past few years largely due to the UPA's reliance on India's communist parties for support in parliament. The ending of this support in 2008 enabled limited reforms to be passed. For example, in February 2009 the government initiated changes that further opened-up certain sectors such as insurance, telecom and retail, to FDI.

Observers expect the government to push through further economic and investment reforms, many of which will provide opportunities for foreign investors. The reform agenda will move forward but likely at a gradual pace, particularly given the diversity of views, even within the Congress party itself.

In November 2009 the Canadian and Indian government concluded negotiations on a bilateral nuclear cooperation agreement which would allow for trade in nuclear technology and related resources; final signing and implementation is expected at some point in 2010. At the same time, the Nuclear Damage Bill currently before parliament, which limits the private sector's liability for damages caused by nuclear disasters, is likely to face strong opposition given the recent controversial Bhopal (1984 industrial disaster) judgment and BP oil spill.

Political Violence: Several terrorist attacks in recent years in many major cities highlight the threat posed by Islamist militant groups within India. The latest - the November 2008 Mumbai attack - involved a dozen gunmen attacking two luxury hotels and singling out foreigners during the sieges which resulted in over 180 deaths. Though there have been no major attacks since 2008, warnings of pending attacks are becoming increasingly common and future attacks in major cities are likely.

Tensions with Pakistan have threatened regional stability since 1947. Several years of peace talks on the disputed Jammu - Kashmir territories have resulted in little progress. The Mumbai attacks led to deterioration in Indo-Pakistani relations due to Indian government allegations of Pakistani government agencies involvement in the attacks.

The ongoing Maoist (Naxalite) insurgency - named the single biggest threat to internal security by Prime Minister Singh - is growing increasingly violent. New Delhi may be forced to take on more responsibility in tackling the Naxalites, an issue that has hitherto been considered an internal matter for individual states to deal with. Hindu/Muslim based communal political violence issues remain as well throughout certain parts of India.

Political Structure

Federal State
Parliamentary Democracy

President

Pratibha Patil

Prime Minister

Manmohan Singh, Indian
National Congress (INC)

National Legislative Bodies

- Lok Sabha (Lower House)
545 members (chosen through direct election)
- Rajya Sabha (represents interests of Indian states)
245 members (233 elected, 12 appointed by President)

Major Parties

- Indian National Congress (INC)
- Bharatiya Janata Party (BJP)
- Samajwasi Party
- Bahujan Samaj Party
- Communist Party of India-Marxist (CPI-M)

Last Elections

April/May 2009

Next Elections

April/May 2014

Press Freedom Survey:

- 2009 Score: 36 - partly free (0: Free; 100: Not Free)
- freedomhouse.org

Control of Corruption Index:

- 2008 Score: -0.37 (-2.5: Worst; +2.5: Best)
- worldbank.org

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Indika Joy Rankothge

irankothge@edc.ca

Political Outlook

The present political scene in India is quite exceptional due to the relatively strong position of the ruling coalition. The Congress-led governing coalition, reelected in May 2009, faces no strong challenges to its position and seems fairly united on most issues. This state of affairs, a relative rarity in Indian coalition politics, has allowed the government to continue pushing through its reform agenda, albeit in a cautious fashion. The security environment is dominated by the threats posed by the Islamic militants (as highlighted by the 2008 Mumbai attacks) and Naxalite insurgent activities.

Economic

Credit Agencies:

Moody's: Baa3
 S&P: BBB-
 Fitch: BBB-

Nominal GDP (2009):

USD 1,285 billions

Population (2009):

1,166 millions

Total Trade / GDP (2009):

48%

Currency:

Indian rupee

Exchange regime:

Managed float

Merchandise imports from Canada (2009)

CAD 1,712 millions

Main sources of Foreign Exchange (excl. FDI):

Remittances
 Software services

Main Merchandise Export Destination:

US (17 %)

Main imports:

Mineral fuels (37%)
 Industrial M&E (16%)
 Precious met. & gems (11%)

Risks to the Outlook

↑ Greater than expected FDI
 Faster G3 recovery

↓ Over-tightening of monetary policy
 More fiscal slippage

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 Jérôme Bourque
 jbourque@edc.ca

Market Spotlight: Economic growth surged to 11.2% y/y in Q1 from an upwardly revised 7.3% in Q4, bringing the FY2009-2010 growth rate to 7.4%. Improved monsoon rains and stronger industrial activity supported the increase. Greater investment spending and the first positive real trade balance since 2005 offset weakening consumer spending. Growth momentum is well entrenched for 2010, but the central bank will need to tighten monetary policy further to contain rising inflation, which is dampening consumer sentiment. All consumer inflation indicators are running near 15% y/y. The central government's budget for 2010-2011 is paving the way for the pullout of fiscal stimulus and fiscal consolidation in the medium-long term after the slippage and stimulus of the last 2 years.

Recent performance: Real GDP growth rose to 11.2% y/y in Q1-10, compared to the upwardly revised 7.3% growth rate in Q4-09, which pushed up FY2009-2010 growth to 7.4%. On a seasonally adjusted basis, real GDP surged 13.5% at an annualized rate. While personal consumption weakened further, to 2.6% y/y, investment activity surged 17.7%, the strongest pace of increase since 2007. On an industry basis, growth was driven by the strongest increase in manufacturing activity on record (+16.3%), and supported by the rapid expansion in the trade, hotel, transport & communications sector. The return of normal monsoon rainfall also resulted in a better performance of the agricultural sector. Industrial activity has shown strong upward momentum recently, clocking in at 17.6% in April, above the 15.1% pace of Q1.

Fiscal policy: The budget for the 2010-2011 fiscal year projects improvements for the deficit after the fiscal stimulus of last year and the large one-off expenditures of the year before. As a share of GDP, the deficit is expected to reach 7.8% of GDP (including off-budget food, fuel and fertilizer price subsidies of 1.7% of GDP) from 9.6% last year and 11.8% in 2008/2009. The improvement will come from a combination of weaker expenditure growth from reduced subsidies, and greater revenues from the acceleration of economic growth, the reversal of indirect tax cuts that were part of the fiscal stimulus package, the expansion of the tax base and the revival of the privatization program, as well as the one-time sale of G3 licenses, which generated over USD 15 billion. Solvency indicators will improve again, but are expected to remain above comfortable levels, with public debt to GDP reaching 68% by 2014-15.

Monetary policy: The Reserve Bank of India (RBI, the central bank) continues its tightening cycle as inflation pressures are building, by raising reserve requirements and its two main interest rates by 50 basis points since the beginning of the year. While better monsoon rains will reduce food prices, the upward trend in M2 growth suggests that additional inflation pressure is in the pipeline for the second half of this year. As such, we expect further tightening going forward, with the Wholesale Price Index (WPI), the RBI's target indicator for inflation, increasing to 10.2% y/y in May, while the various consumer price indices are all showing increases around 15% in April.

External sector: Strong domestic demand and higher energy prices are again putting pressure on the trade deficit, which totalled USD 27.1bn in Q1-10. While exports are rebounding, up 36% y/y in April, in parts due to weak base effects, imports are rising at a much faster pace, up 43% y/y. However, the trade deficit is supported by strong transfers from abroad, renewed foreign investment inflows, as well as the return of external demand for India's software services, to a record amount in Q4. Nonetheless, foreign exchange reserves continue to slowly decline since October 2009, falling to USD 261bn at the end of February, which still represent over 8 months of current account debit cover.

Outlook: Despite the uncertain outlook for developed economies, further monetary tightening in the pipeline and the beginning of pullout of fiscal stimulus, real GDP growth in India will accelerate this year and next, reaching 7.5% this year and 7.9% in 2011. Investment and industrial activity, which is more oriented towards the domestic market, will sustain growth, while consumer sentiment will be dampened by high inflation. The election victory of the Congress Party bodes well for continued economic reforms, with the move towards gradual liberalization and deregulation expected to continue under the current government. While sustained annual double-digits growth remains a few years away, a return to the 8-9% growth rates seen before the crisis is very likely.

Economic Indicators

	04-08 avg.	2009	2010	2011
GDP (% growth, real)	8.5	5.7	7.5	7.9
Inflation (% , year-end)	5.8	10.9	10.7	5.7
Fiscal Balance (% of GDP)	-3.9	-7.7	-6.4	-6.1
Exports (% growth)	27.0	-17.9	16.1	12.1
Imports (% growth)	33.7	-22.1	20.0	16.0
Current Account (% of GDP)	-1.1	-0.8	-1.0	-1.3
Reserves (month of imports)	9.1	9.8	9.4	8.9
External Debt (% of GDP)	17.5	17.4	15.7	14.5
Debt Service ratio	11.0	9.8	8.0	7.5
Currency (per USD, year-end)	44.2	46.7	44.0	41.0

Source: EIU, EDC Economics

Real GDP Growth

