

Political

General Political Environment: The Indian National Congress (Congress) and its allies in the United Progressive Alliance (UPA) were re-elected to a second five-year term in 2009. 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.

The biggest surprise of the election was the stumbling of several of some of the prominent regional parties. The rise in prominence of regional parties (i.e. parties with a political presence in fewer than four states) in Indian national politics has been one of the most significant political developments to occur in contemporary India, with over 30 political parties represented in Parliament.

In the lead-up to the elections, there were predictions that the reign of the national parties had come to an end and that the political future lay with the plethora of regional parties, if not as kings then at least as king-makers. While certain of these parties did succeed in increasing their positions, the majority of seats that changed hands went to Congress. Although regional parties will remain essential in Indian national politics given the role they play in multi-party coalitions, the 2009 election results reflect the continued prominence of national parties, namely Congress.

In December 2009 the Indian government announced a decision 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.

One expectation is that the re-elected UPA government will now be in a position 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 on these issues, 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.

Political Violence: Several terrorist attacks in recent years in many major cities have highlighted the threat posed by Islamist militant groups within India. The latest and most devastating of these attacks occurred in Mumbai in November 2008. Over a period of three days, a dozen gunmen attacked two luxury hotels and a rail terminus, killing over 180 people and singling out foreigners during the hotel sieges, particularly UK and US nationals. There has not been a major Islamist attack in India since the 2008 Mumbai attacks; however, 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 Kashmir issue have resulted in little progress and the area remains volatile. The Mumbai attacks led to a deterioration in Indo-Pakistani relations as many of the attackers were Pakistani with the Indian government claiming that Pakistani government agencies may have also been involved.

Other political violence issues include sporadic Hindu/Muslim communal violence, the ongoing Maoist (Naxalite) insurgency in central and eastern India and ongoing separatist insurgencies in the northeastern states.

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 2012

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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Peter Whelan

pwhelan@edc.ca

Political Outlook

Elections held in 2009 provided the Congress-led UPA coalition with a strengthened mandate, which should ensure its interrupted rule over the next five years. Its situation is much stronger than its previous term when it required significant support from outside the coalition. The UPA's strengthened position will allow the government to move forward on investment-related reform, albeit gradually. Although political violence is a fairly common occurrence in India, the Mumbai attacks of November 2008 were shocking due to the level of sophistication and the selection of targets, including the focus on foreigners. The Mumbai attacks underscore the ongoing risk of terrorist attacks throughout the country, and also set Indo-Pakistani relations back several years.

Economic

Credit Agencies:

Moody's: Baa3

S&P: BBB-

Fitch: BBB-

Nominal GDP (2008):

USD 1,164 billions

Population (2008):

1,148 millions

Total Trade / GDP (2008):

41.4%

Currency:

Indian rupee

Exchange regime:

Managed float

Merchandise imports from Canada (Jan-Sep 2009)

CAD 1,386 mn (-6.0%)

Main sources of Foreign Exchange (excl. FDI):

Manufactured goods

Remittances

Main Merchandise Export Destination:

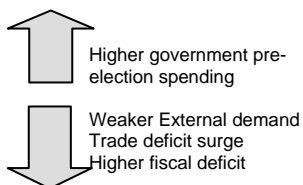
US (17%)

Main imports:

Manufactured goods (30%)

Mineral fuels (8.7%)

Risks to the Outlook



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Anne-Marie Shaker
ashaker@edc.ca

Market Spotlight: Economic performance remained fairly resilient despite the global downturn aided by robust private consumption and a substantial fiscal stimulus. GDP is forecast to clock in at 6.4% for the Calendar (CY) and 6.5% for the Fiscal Year (FY) in 2009. Short term, poor monsoon rainfall will exacerbate the downside, and going forward, a precarious fiscal situation, if left to worsen further, will ultimately weigh on long term growth potential...

Recent performance: Growth in the third quarter accelerated to 7.9% y/y from 6.2% in the second and 5.8% in first. Growth had slowed to 7.4% for 2008 and is expected to remain below trend over the next few quarters. Continued high government stimulus spending and resilient and improving private demand were the main drivers. Industrial production expanded 9.2% y/y in September, following an 11% y/y increase in August, but the latter's expansion benefited from base effects due to the slow growth a year earlier. The lower monsoon rains this year have so far not had the anticipated negative effects on growth.

Fiscal policy: The budget for the FY09/10 fiscal year projected a worsening of the deficit to 6.8% of GDP from 6.0% the previous year and a decline in tax revenues to 10.9% of GDP from 11.6%. Total expenditure of the central government is to increase to 17.4% of GDP on the back of higher food subsidies and outlays on welfare and job creation programs particularly in rural areas to boost demand and maintain the growth trajectory. The time given to small farmers to pay their overdues under the debt waiver and the debt forgiveness scheme has been extended to end of year. More money will be pumped into the National Rural Employment Guarantee scheme which ensures each rural family 100 days of work on public sector projects. Much-needed infrastructure spending will increase. Fiscal consolidation is to be sacrificed for short term growth and is to return in the medium long term. The budget does not contain major reforms to benefit private business and foreign investors. The higher deficit will exacerbate the debt to GDP ratio which is projected to reach over 80% by the end of the fiscal year.

Monetary policy: The aggressive monetary easing cycle has come to an end, the repo rate and the reverse repo rate will remain at 4.75% and 3.25% respectively until year end. Some gradual withdrawal of accommodative measures has begun as signs of an economic recovery are proving more robust and are putting upward pressure on prices. October Whole Sale Price Index (WPI) rose 1.3% y/y from 0.5% y/y in September, while the Consumer Price Index (CPI) surged 11.5% y/y due to the heavier weighting of food prices (affected by low agricultural output due to weak rains) in the consumer price basket compared to the whole sale price basket. Lower policy rates are slowly translating into lower commercial bank lending rates, but businesses remain cautious about borrowing and investing and domestic credit sluggish.

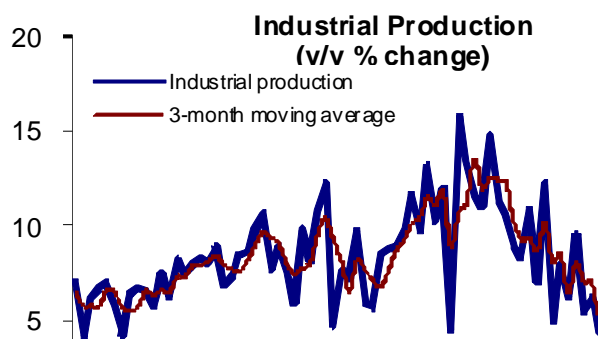
The external sector: Record trade deficits in 2008 were due to surging oil prices. The subsequent plunge in commodity prices failed to materialize into substantial current account gains in late 2008 due to dismal export performance. The significant drop in imports in 2009 has led to an improvement in the current account deficit in the first quarter of this year after a marked deterioration in the last three quarters of 2008. The overall balance of payment (BOP) figures for the first half of 2008 showed a surplus, but by the second half of the year this no longer held true. The BOP is now once again in positive territory due to a firming on the capital account side but the current account side has weakened substantially. Foreign reserves, while sizeable, had been pressured in recent months, but picked up again in September reaching over USD 264 billion and representing over 9.4 months of current account debit cover. The external debt is small at 18.7% of GDP supporting solvency. The rupee depreciated in 2008, losing 20.7% against the USD, but in 2009 it has regained its lost strength.

Outlook: Growth will slide to 6.4% in CY-2009 6.5% in CY-2010 (6.5% in FY-2009 and 7.0% in FY-2010), while the medium term outlook remains favourable. While elections have ended, the push for substantial reforms is expected to be limited despite reformist appetite. The move towards gradual liberalization and deregulation will continue under the new government; but a major overhaul is unlikely. The dire state of the country's infrastructure will need to be addressed, since it is not at par with the economy's stance as Asia's second powerhouse. The effect of pre-election spending and the stimulus package as growth boosters will begin to fade with added pressure due to agricultural sector woes. We expect medium term growth to return to its current growth potential of over 7% but not before 2011.

Economic Indicators

	03-07 avg.	2008	2009	2010
GDP (% growth, real)	8.9	7.4	6.4	6.5
Inflation (% , year-end)	4.9	8.2	5.4	4.4
Fiscal Balance (% of GDP)	-3.8	-6.0	7.0	-4.8
Exports (% growth)	24.3	20.1	-8.0	10.6
Imports (% growth)	30.7	33.1	-8.5	12.1
Current Account (% of GDP)	-0.3	-3.6	-4.0	-3.9
Reserves (month of imports)	9.9	7.6	7.7	6.5
External Debt (% of GDP)	16.0	14.0	14.6	13.8
Debt Service ratio	10.5	6.2	7.1	6.5
Currency (per USD, year-end)	43.6	48.8	47.0	45.8

Source: EIU, EDC Economics



Source : Bloomberg