

INDIA Country Report

Data Sheet of India

GDP growth 2006e	8,3%
GDP growth 2007e	7,4%
Industrial production latest 12 month	14,4%
Consumer price inflation latest 12 month	6,3%
Consumer price inflation 2007 forecast	6,1%
Unemployment rate	7,6%
Current account balance latest 12 month, \$bn	-13,7
Current account as % of GDP	-2,2%
Trade balance latest 12 month, \$bn	-48,8
Currency units, per US\$	44,2 Rs
Budget balance % of GDP 2007	-4,3%
Interest rates, 3-month rate in %	7,1%
Interest rates, 10 year bond rate in %	8,0%
Stock Market Index (BSE) as of Jan 17th 2007	14131,3
Currency units, per US\$ forecast end 2007	42,0 Rs
Stock Market Index (BSE) forecast for end 2007	13.500,0
Interest rate forecast, 10 year bond for end 2007	8,2%
e = estimate	

Map of India



Methodology

In this report we give an overview of the economic, financial and political environment of a specific country. Based on that analysis we are developing a forecast for the main financial indicators though a the interest rates and the stock market indices for the coming year. We do not analyse or comment every single aspect of the economy, because we try to filter out the determining factors, which will effect the stock and bond markets.

Overview

India has enjoyed a string growing economy in the past years and is on the best way to catch up to China. Significant differences remain. India faces an infrastructure bottleneck which reduces its potential growth rate, but it is a democracy and has a large well educated english speaking population, which enables it to integrate easier into the world economy.

Political environment

The United Progressive Alliance (UPA), a coalition led by the Indian National Congress, gained the largest number of seats and formed a minority government, installing Manmohan Singh as prime minister. The UPA requires additional parliamentary backing in order to govern, and is currently supported by the Left Front, a group of left-wing parties dominated by the Communist Party of India (Marxist).

The booming economy is likely to enable the Indian National Congress-led United Progressive Alliance (UPA) coalition government not only to remain in power until 2009 but also to relaunch its stalled programme of economic reforms. The government's greatest opportunity to do this will be in 2007, as much of its agenda in 2008 will be given over to preparations for the next general election, which is scheduled to take place by May 2009. Monetary policy will continue to be tightened in the first half of 2007, but will be eased gradually thereafter. Real GDP growth is forecast to remain strong in fiscal year 2006/07 (April-March) and then to moderate slightly in 2007/08 and 2008/09. Strong domestic demand will lead to a significant widening of the merchandise trade deficit over the forecast period, but surpluses on the services and transfers accounts will limit the current-account deficit to less than 3% of GDP in 2007-08. Inflationary pressures will be difficult to control.

Outlook

The Indian National Congress-led government is likely to remain in power until the end of its full term of office in May 2009. The other parties in the ruling United Progressive Alliance coalition, and the Left Front communist parties that support it, have little to gain by bringing down the government. The result of the next general election will be another fractured mandate, with three potential groupings that could win power: a BJP- or Congress-led coalition, or an alliance of left-wing and regional parties.

The dispute with Pakistan over the future of Kashmir will remain at the centre of India's diplomatic concerns. Relations are forecast to remain relatively constructive, and armed exchanges are likely to remain confined to border areas. Relations between India and the US will strengthen throughout the forecast period.

A renewed effort to liberalise the economy in 2007 will be limited by the practicalities of coalition politics (particularly demands made by the government's Left Front allies) and by Congress's focus on the rural sector. Nevertheless, past liberalisation means that the private sector has already become sufficiently dynamic to ensure that economic growth will remain strong.

India's economic boom will continue, albeit at a slightly slower pace. Real GDP growth (by expenditure) is forecast to slow from 8.7% in fiscal year 2006/07 (April-March) to an annual average of 7.3% between 2007/08 and 2011/12. Information technology (IT) and IT-enabled services (ITES) output will grow rapidly in the forecast period, owing to India's cost advantages in these sectors.

Current account

India will record large surpluses on its services account over the forecast period, thanks to foreign earnings from IT and ITES. Although the merchandise trade account will post an expanding deficit, reflecting high global oil prices and an increase in local demand for consumer goods, this will be sustainable thanks to continued inflows of remittances from Indians working overseas and to the rising services surplus.

Monetary policy

Amid general evidence of mounting inflationary pressures and an asset price bubble, the Reserve Bank of India (RBI, the central bank) will maintain a bias towards monetary tightening in the first half of 2007. Monetary policy will move to a more neutral orientation in 2008-11, provided that the rupee does not come under sustained downward pressure and that annual wholesale price inflation does not exceed the RBI's target range of 5-5.5%.

Financial markets

Under the conditions stated above, the tightening bias of the RBI will lead to higher short- and long-term interest rates and a cooling of the stock market. At this time the Indian stock market with a price earnings ratio between 15 and 18 depending on earnings estimates for 2007 is one of the highest valued emerging markets stock market in the world. Relative to 10 year bond interest rates of around 8.0%, representing a bond market multiple of around 12.5, the Indian stock market appears overvalued to us. The potential earnings growth rates of Indian companies is undisputed but actually with a tightening bias of the RBI and a "not easing" policy of the Federal Reserve of the USA for the next couple of months, we consider the Indian stock market overvalued at this time. We mention the monetary policy of the FED at this point, because American investors are among the most active in emerging markets and they are driven by monetary conditions at home..

Under these circumstances we arrive at our estimates of 10 year government bond rates of about 8.2% in India at the end of 2007 and an estimated Bombay Stock Exchange (BSE) Index of 13,500.00 points at that time.

Sources for economic data: Reserve Bank of India
Estimates: Own estimates and own calculations