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Constructive on structural and cyclical growth outlook

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India moved up 30 positions in the World Bank's latest "Ease of Doing Business" ranking (published this week) to secure the 100th spot, which is a remarkable feat, in our view, and an acknowledgement of the various growth critical and structural reforms that are operational at present and those which have been implemented in the last few years. The list of reforms is impressive and should lead to further improvement in the ranking when the beneficial effects of demonetization and GST are taken into consideration, in our view. From a structural perspective, we remain positive regarding India's medium term macro outlook, with political and macro stability being in place, and given the determination of the authorities to continue with growth-critical reforms.

While the long term structural macro outlook remains unambiguously positive, we think India is also poised for a cyclical upturn in growth, and that the worst of the growth-slowdown, caused by temporary disruption and technical factors related to external trade, is behind us. The economy has already started to stabilize post GST and high frequency indicators are showing a rebound, which should eventually reflect a recovery in July-Sep'17 GDP growth (DB estimate 6.4%). While we expect growth to average around 6.6% during FY18, we are more optimistic about the outlook for FY19 and beyond.

We also note that growth momentum generally improves in the year prior to the elections (India's next general elections are to be held in May 2019 or earlier), which is likely to play out in this cycle as well. We think given the various reforms that are operational at this stage and that have been implemented by this government so far, it is reasonable to expect growth to return close to 8.0% by FY20, absent any external shock that could jeopardize this baseline outlook.

Figure 1: Key forecasts

Financial year (ending 31 March)	FY15	FY16	FY17	FY18F	FY19F
Real GDP (YoY %)	7.5	8.0	7.1	7.0	7.5
Central Govt. fiscal deficit, % of GDP	-4.1	-3.9	-3.5	-3.2	-3.0
Consolidated fiscal deficit, % of GDP	-6.6	-6.5	-6.5	-6.2	-6.0
CPI (YoY%) avg	6.0	4.9	4.5	3.3	4.5
Current account balance, % of GDP	-1.3	-1.1	-0.7	-1.3	-1.5
Calendar year	2014	2015	2016	2017F	2018F
Trade balance, % of GDP	-7.2	-6.6	-4.7	-5.3	-5.1
Current account balance, % of GDP	-1.4	-1.1	-0.5	-1.3	-1.5
INR/USD, eop	63.3	66.3	67.9	66.0	66.0

Source: CEIC, Deutsche Bank forecasts

Data monitor

Figure 2: Key macro variables – monthly trend

Real sector (% yoy)	Sep-16	Oct-16	Nov-16	Dec-16	Jan-17	Feb-17	Mar-17	Apr-17	May-17	Jun-17	Jul-17	Aug-17	Sep-17	Oct-17
Industrial production	5.0	4.2	5.1	2.4	3.5	1.2	4.4	3.2	2.9	-0.2	0.9	4.3		
Mining and quarrying	-1.2	1.0	8.1	10.8	8.6	4.6	10.1	3.0	0.3	0.4	4.5	9.4		
Manufacturing	5.8	4.8	4.0	0.6	2.5	0.7	3.3	2.9	2.6	-0.5	-0.3	3.1		
Electricity	5.1	3.0	9.5	6.4	5.1	1.2	6.2	5.4	8.3	2.1	6.6	8.3		
Capital goods	-7.5	-4.7	5.3	-6.2	-0.6	-2.4	9.4	-4.8	-1.6	-6.6	-1.3	5.4		
Consumer durables	10.3	1.5	6.8	-5.0	-2.0	-4.6	-0.6	-0.7	0.6	-2.4	-3.6	1.6		
Consumer non-durables	12.7	5.6	3.3	-0.2	9.6	10.4	7.5	8.8	9.7	4.7	3.6	6.93		
Core infrastructure production	5.3	7.1	3.2	5.6	3.4	0.5	5.2	2.6	3.9	1.0	2.6	4.4	5.2	
Auto sales	15.9	7.2	-4.2	-16.0	-5.1	2.4	2.9	9.5	9.6	1.8	12.0	13.5	10.3	
Manufacturing PMI	52.1	54.4	52.3	49.6	50.4	50.7	52.5	52.5	51.6	50.9	47.9	51.2	51.2	50.3
Services PMI	52.0	54.5	46.7	46.8	48.7	50.3	51.5	50.2	52.2	53.1	45.9	47.5	50.7	
Composite PMI	52.4	55.4	49.1	47.6	49.4	50.7	52.3	51.3	52.5	52.7	46.0	49.0	51.1	
Monetary sector (%yoy)														
CPI inflation	4.4	4.2	3.6	3.4	3.2	3.7	3.9	3.0	2.2	1.5	2.4	3.3	3.3	
Core CPI inflation	5.3	5.3	5.2	5.1	5.0	4.7	4.7	4.6	4.4	4.2	4.4	4.7	4.8	
WPI inflation	1.4	1.3	1.8	2.1	4.3	5.5	5.1	3.9	2.3	0.9	1.9	3.2	2.6	
M3 (broad money supply)	13.6	10.4	8.5	6.6	6.4	6.5	10.6	7.1	7.0	7.4	6.5	7.0	6.0	
Credit to commercial sector	11.7	8.4	6.2	4.9	4.7	4.5	8.3	4.9	4.8	5.7	4.8	5.9	6.4	
Aggregate deposits	13.9	9.8	15.9	14.5	13.2	12.1	15.2	10.9	10.3	10.5	9.8	9.7	8.1	
Repo rate (%)	6.50	6.25	6.25	6.25	6.25	6.25	6.25	6.25	6.25	6.25	6.25	6.00	6.0	6.0
External sector (% yoy)														
Exports	4.1	8.8	2.5	6.4	5.1	22.5	27.2	17.9	7.5	3.7	3.0	10.3	25.7	
Imports	-0.6	10.7	12.0	1.2	10.6	21.2	45.3	48.1	34.0	16.9	16.2	21.0	18.1	
Non-oil-non-gold imports	-1.0	5.0	11.9	5.3	3.9	3.9	19.8	43.1	21.2	15.7	12.9	20.7	19.8	
Trade Balance (USD bn)	-9.1	-11.1	-13.4	-10.5	-9.6	-7.7	-10.5	-13.4	-13.8	-12.7	-14.1	-11.6	-9.0	
FX Reserves (USD bn)	372.0	366.2	361.1	358.9	363.0	364.3	370.0	373.3	380.1	386.5	393.7	397.8	400.2	399.9
Net FII inflows	3.0	-1.5	-5.8	-4.0	-0.5	2.4	8.6	3.5	4.2	4.5	3.7	0.4	-1.5	2.9
FII equity	1.6	-0.6	-2.7	-1.2	-0.2	1.5	4.7	0.4	1.2	0.6	0.8	-2.0	-1.8	0.5
FII debt	1.5	-0.9	-3.1	-2.8	-0.3	0.9	3.9	3.1	3.0	4.0	2.9	2.4	0.2	2.5
Net FDI	6.3	4.2	3.6	2.0	4.1	1.0	-0.1	1.7	3.4	2.1	4.0	8.6		
INR/USD	66.7	66.9	68.5	68.0	67.8	66.7	64.8	64.2	64.5	64.7	64.1	64.0	65.4	64.8
REER (36 currency, trade based)	114.5	114.9	115.9	116.8	115.2	115.7	117.6	120.0	118.8	118.3	118.2	118.3	116.8	
RBI FX intervention (net, USDbn)	4.6	-0.4	-2.7	0.5	-0.4	1.2	3.5	0.6	5.0	3.3	3.0	3.2		

Source: CEIC, Bloomberg Finance LP, RBI, CSO, various ministries of Government of India, Deutsche Bank

Figure 3: GDP and Balance of Payments – quarterly trend

National accounts, % yoy	Q1-2015	Q2-2015	Q3-2015	Q4-2015	Q1-2016	Q2-2016	Q3-2016	Q4-2016	Q1-2017	Q2-2017
Real GDP at Market Price	7.3	7.6	8.0	7.2	9.1	7.9	7.5	7.0	6.1	5.7
Final Consumption Expenditure	5.8	2.5	5.0	6.3	8.7	9.8	9.5	12.5	10.2	8.5
Pvt. Final Consumption Exp	7.6	2.8	5.2	6.7	9.3	8.4	7.9	11.1	7.3	6.7
Govt. Final Consumption Exp	-5.5	0.9	4.3	4.2	4.1	16.6	16.5	21.0	31.9	17.2
Gross Fixed Capital Formation	2.9	4.3	3.4	10.1	8.3	7.4	3.0	1.7	-2.1	1.6
Exports of Goods & Services	-4.5	-6.1	-4.1	-8.7	-2.3	2.0	1.5	4.0	10.3	1.2
Imports of Goods & Services	-4.0	-5.9	-3.4	-9.9	-4.3	-0.5	-3.8	2.1	11.9	13.4
Balance of Payments, $ bn	Q1-2015	Q2-2015	Q3-2015	Q4-2015	Q1-2016	Q2-2016	Q3-2016	Q4-2016	Q1-2017	Q2-2017
Exports	71.8	68.0	67.6	64.9	65.8	66.6	67.4	68.8	77.4	73.7
Imports	103.4	102.2	104.7	98.9	90.6	90.5	93.0	102.0	107.1	114.9
Trade balance	-31.6	-34.2	-37.2	-34.0	-24.8	-23.8	-25.6	-33.3	-29.7	-41.2
Net invisibles	30.9	28.0	28.6	26.9	24.4	23.4	22.1	25.3	26.3	26.9
Current account	-0.6	-6.1	-8.6	-7.1	-0.3	-0.4	-3.5	-8.0	-3.5	-14.3
Capital account	30.0	18.6	8.1	10.9	3.5	7.2	12.8	6.1	10.4	25.4
o/w: FDI	9.3	10.0	6.5	10.7	8.8	3.9	17.0	9.7	5.0	7.2
Portfolio investment	13.7	0.2	-3.4	0.6	-1.5	2.1	6.1	-11.3	10.8	12.5
BoP Balance	30.1	11.4	-0.9	4.1	3.3	7.0	8.5	-1.2	7.3	11.4

Source: CEIC, Bloomberg Finance LP, RBI, CSO, various ministries of Government of India, Deutsche Bank

Structural outlook

India makes significant progress in its quest to become a "STAR" economy

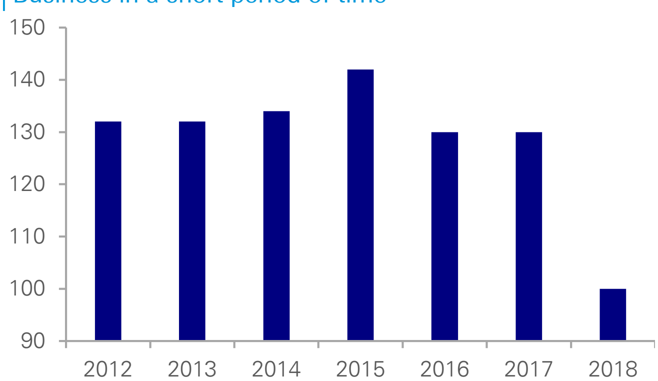
India's growth momentum has been affected in the last few quarters due to temporary disruption caused by demonetization and GST, which in our view are landmark reforms and will eventually result in increasing the potential growth rate of the economy in the medium to long term.

Before we delve deeper into India's short term growth dynamic and the outlook going forward, we would like to highlight the improvement made by India in the World Bank's "**Ease of Doing Business Ranking**", which is keenly followed by investors across the world.

India moved up 30 positions in the World Bank's latest "Ease of Doing Business" ranking (published this week) to secure the 100th spot (last year India was ranked 130th out of 190 countries surveyed), which is a remarkable feat, in our view, and an acknowledgement of the various growth critical and structural reforms that are operational at present and those which have been implemented in the last few years. The list of reforms is impressive and should lead to further improvement in the ranking when the beneficial effects of demonetization and GST are taken into consideration, in our view. Since 2014, India has moved up 42 positions, which is by far the biggest improvement made by any major country covered in the survey.

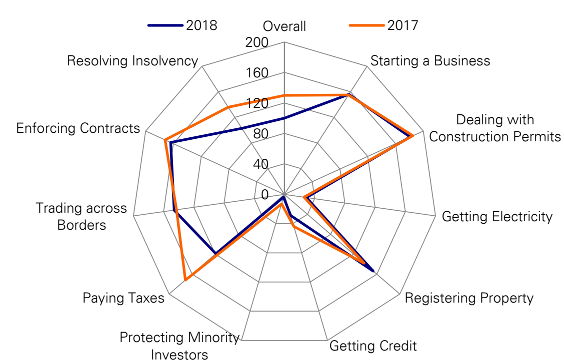
The World Bank's Ease of Doing Business index ranks are based on 10 indicators which are: starting a business, dealing with construction permits, getting electricity, registering property, getting credit, protecting minority investors, paying taxes, trading across borders, enforcing contracts and resolving insolvency. India has improved its ranking in 6 out of these 10 indicators, as per the latest survey results.

Figure 4: Significant improvement in Ease of Doing Business in a short period of time



Source: World Bank and Deutsche Bank

Figure 5: Given the focus on reforms, India is likely to make further progress in the ranking next year



Source: World Bank and Deutsche Bank

Figure 6: Comparison between 2018 and 2017 score

	2017	2018
Overall	130	100
Starting a Business	155	156
Dealing with Construction Permits	185	181
Getting Electricity	26	29
Registering Property	138	154
Getting Credit	44	29
Protecting Minority Investors	13	4
Paying Taxes	172	119
Trading across Borders	143	146
Enforcing Contracts	172	164
Resolving Insolvency	136	103

Source: World Bank and Deutsche Bank

We remain positive on the medium term macro outlook of the Indian economy, with political and macro stability being in place, and given the determination of the authorities to continue with growth-critical reforms. As we have mentioned before, **India has embarked on a journey to transform itself into a STAR (simple, transparent, affluent and resilient) economy, and the progress so far has been extremely positive.** The goal should be to endure with the ongoing reforms and focus on new reforms, which would be beneficial for the economy from a medium to long term perspective. Despite what has been achieved so far, there is a lot of scope for incremental improvement, both in terms of India's own potential and also in comparison to other EM peers, and we are confident that the authorities will push harder in the coming years to ensure that most of the medium term objectives are met.

Reforms agenda: Transforming India into a "STAR" economy

* **Simple –** Improve ease of doing business ranking, liberalize and simplify FDI norms further, simplification of indirect tax structure through implementation of GST

* **Transparent –** Fair and transparent method of e-auctioning of national resources, reduced distortion and discretion through de-regulation of petrol and diesel prices, improve subsidy delivery through direct benefits transfer, ushering in greater transparency in the lending process by implementing Bankruptcy Code, demonetization to reduce black money and cash usage in the economy, enforcement of Benami Act, abolition of cash transaction above INR200,000 and transparency in political funding by capping donation from each source to just INR2,000

* **Affluent –** Shift in policy stance with focus currently on wealth creation rather than poverty alleviation, focus on expediting pace of urbanization through Smart Cities mission along with digitization to make India more prosperous

* **Resilient –** commitment to keep inflation low, maintain positive real interest rate in the economy, fiscal consolidation, focus on maintaining rupee stability in a challenging global macro backdrop

Cyclical outlook

The link between external trade and growth

In April-June'17, India's real GDP growth slowed down to 5.7%yoy, led by de-stocking ahead of GST implementation from 1 July and also on account of net exports subtracting substantially (-2.6%) from growth. In this weekly, we delve deeper into the external trade dynamic in 2017 to understand its impact on growth and what could be the likely path going forward.

Global oil prices, oil imports and oil exports. We note that global oil prices (Brent) have gone up 23%yoy on an average basis in Jan-September of 2017 versus the corresponding period of the previous year. Therefore, it is natural that oil imports and oil exports growth would be significantly higher this year compared to the previous year. Oil imports and oil exports were up 33%yoy and 31%yoy respectively in the Jan-Sep'17 period, pushing the trade deficit up by about 59%yoy. From a fiscal year perspective, oil imports and oil exports were up 18%yoy and 25%yoy respectively in the April-Sep'17 period, leading to a 63%yoy jump in trade deficit during the first half of the current fiscal year.

Gold imports. Gold imports were also up sharply in the first nine months of 2017, compared to the corresponding period of the previous year. Gold imports were up 102%yoy in Jan-Sep'17, 114%yoy in April-Sep'17, with the most significant increase witnessed during April-June'17 (+187%yoy), just ahead of the implementation of GST from 1 July. Stock piling ahead of GST and a depressed base of the last year led to this sharp spike in gold imports during April-June, post which the pace of increase has eased somewhat in July-Sep (+43%yoy). Indeed, in September gold imports were down 5.0%yoy, with the monthly import value falling below USD2bn (USD1.7bn) for the first time since August 2016.

Figure 7: External trade - quarterly trend

USDbn	Jan-Mar' 16	Jan-Mar'17	% yoy	Apr-Jun' 16	Apr-Jun' 17	% yoy	Jul-Sep' 16	Jul-Sep' 17	% yoy
Exports	65.0	77.0	18.5	65.9	72.2	9.5	63.8	72.4	13.6
Oil exports	6.2	9.0	45.2	6.8	8.1	19.0	7.6	9.9	30.7
Imports	83.6	104.8	25.4	84.9	112.1	32.1	90.5	107.1	18.4
Gold imports	5.3	9.7	83.3	3.9	11.3	187.4	4.0	5.7	42.7
Oil imports	14.7	25.6	74.3	19.0	22.9	20.3	20.5	23.7	15.5
Memo item									
Non-oil exports	58.7	68.0	15.7	59.1	64.1	8.4	56.2	62.5	11.3
Non-oil imports	68.9	79.2	15.0	65.9	89.3	35.4	70.0	83.4	19.3
Non-oil-non gold imports	63.6	69.5	9.3	62.0	78.0	25.8	66.0	77.7	17.8
Trade deficit	-18.6	-27.9	49.4	-19.0	-39.9	110.5	-26.7	-34.7	30.0
Dubai crude price avg. (USD/bbl)	30.8	52.8	71.7	43.0	49.7	15.5	43.4	50.6	16.7
Brent crude price avg. (USD/bbl)	34.5	54.1	56.6	46.0	50.1	9.0	45.8	51.73	12.9

Source: CEIC and Deutsche Bank

Total exports and imports. Overall, imports exceeded exports growth during Jan-Sep'17 (25%yoy vs. 14%yoy) as well as April-Sep'17 (25%yoy vs. 11.5%yoy), thereby leading to a widening of the trade deficit from the corresponding period of the previous year. We have two further observations to make. We note that exports growth slowed down suddenly and substantively during the months of May, June and July in 2017, rebounding thereafter in August (10.3%yoy) and September (25.7%yoy). GST could have played a role in reduction of the exports growth momentum, but we suspect that other factors were into play as well which led to the slowdown. But before discussing what "other factors" may have caused the exports slowdown, we would like to highlight the trend regarding non-oil-non-gold imports.

Figure 8: External trade - calendar year and fiscal year trend

USDbn	April-Mar' 16	April-Mar'17	% yoy	April-Sep' 16	April-Sep' 17	% yoy	Jan-Sep' 16	Jan-Sep' 17	% yoy
Exports	262.3	274.1	4.5	129.7	144.6	11.5	194.7	221.6	13.8
Oil exports	30.6	34.0	11.2	14.4	18.0	25.1	20.6	27.0	31.2
Imports	381.0	382.7	0.4	175.4	219.3	25.0	259.0	324.1	25.1
Gold imports	31.8	27.4	-13.6	7.9	17.0	114.3	13.2	26.7	101.9
Oil imports	82.9	86.9	4.7	39.5	46.6	17.8	54.2	72.1	33.1
Memo item									
Non-oil exports	231.7	240.1	3.6	115.3	126.6	9.8	174.1	194.6	11.8
Non-oil imports	298.1	295.8	-0.8	135.9	172.7	27.1	204.8	251.9	23.0
Non-oil-non gold imports	266.3	268.4	0.8	127.9	155.7	21.7	191.6	225.3	17.6
Trade deficit	-118.7	-108.5	-8.6	-45.7	-74.6	63.4	-64.3	-102.5	59.4
Dubai crude price (USD/bbl)	45.9	46.8	2.0	43.2	50.1	16.1	39.0	51.0	30.7
Brent crude price (USD/bbl)	47.5	49.0	3.1	45.9	50.9	10.9	42.1	52.0	23.4

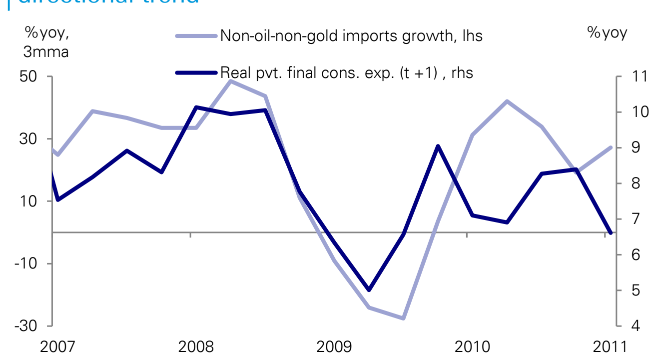
Source: CEIC and Deutsche Bank

Non-oil-non-gold-imports. Non-oil-non-gold (NONG) imports growth is generally considered as a proxy for the health of domestic demand in an economy, and an upward momentum in the former normally indicates an improvement in the latter's growth trajectory, with a lag of about at least one quarter. Indeed, there used to be a very close correlation between NONG imports growth and investment growth rate under the old GDP series data. NONG imports growth and private consumption growth also used to show broadly similar directional trend. But we note that the trend has not only broken under the new GDP data, but has become opposite, particularly from the latter half of 2016. NONG imports growth turned positive from October of last year and since then the momentum has improved sharply, but investment growth has continued to move in the opposite direction throughout this period. Except for the demonetization led unusual spurt in private consumption growth during Oct-Dec'16 (11.1%yoy in real terms), momentum in this component has also slowed steadily since mid of last year, adding to the divergence.

Figure 9: There was a close correlation between NONG imports growth and investment growth momentum under the old GDP series data

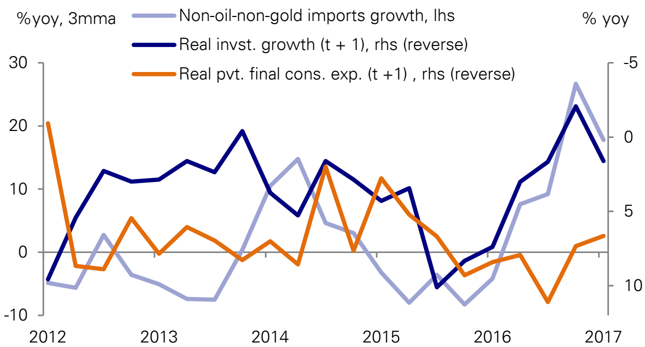
Source: CEIC and Deutsche Bank

Figure 10: Private final consumption growth and NONG imports growth also used to show broadly similar directional trend



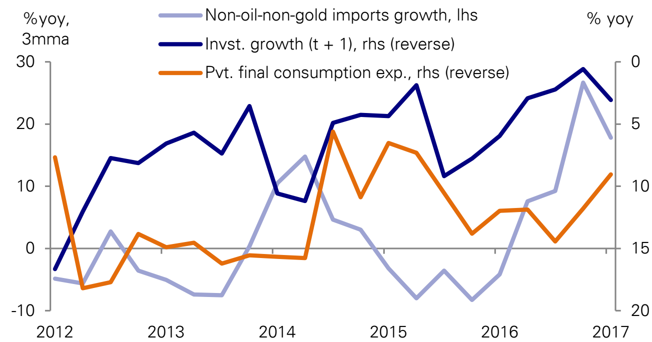
Source: CEIC and Deutsche Bank

Figure 11: NONG imports growth vs. real investment and real private consumption growth: showing a negative correlation



Source: CEIC and Deutsche Bank

Figure 12: NONG imports growth vs. nominal investment and nominal private consumption growth: same divergence



Source: CEIC and Deutsche Bank

Contribution of top 10 items to import growth. In order to understand the trend of NONG imports better, we list down 10 key items of imports and calculate their contribution to growth during April-Sep'17 period along with the trend of the corresponding period of the last two years. Out of the 25%yoy imports growth achieved in April-Sep'17, oil and gold imports contributed 38% to that growth, while other components of NONG imports – electronic goods, pearls/precious stones, coal, chemicals, iron & steel, plastic and machinery contributed 51% to that growth. Interestingly, **we see the biggest swing has been in case of electronic goods, which have grown 35.7%yoy in April-Sep'17 and contributed 4.0% to the overall 25%yoy imports growth during the first half of the fiscal year.**

Figure 13: Contribution of top 10 items to import growth

	Contribution to Imports			%yoy		
Key Imports	Apr-Sep'15	Apr-Sep'16	Apr-Sep'17	Apr-Sep'15	Apr-Sep'16	Apr-Sep'17
Petroleum, Crude and Products	-14.8	-4.4	4.3	-41.8	-18.3	19.3
Electronic Goods	0.7	-0.2	4.0	9.1	-2.3	35.7
Pearl, Precious, Semi Precious Stones	-1.0	0.9	3.0	-19.5	17.6	44.8
Gold	1.2	-4.7	5.2	18.4	-54.6	114.3
Machinery, Electrical and Non Electrical	0.2	-0.3	1.1	4.1	-4.0	14.9
Coal, Coke and Briquittes, etc	-0.6	-0.4	2.3	-15.6	-10.6	64.0
Organic and Inorganic Chemicals	-0.5	-0.3	0.8	-10.7	-7.7	16.2
Artificial Resins, Plastic Materials, etc	-0.1	0.0	0.7	-3.6	-1.4	18.8
Iron and Steel	-0.1	-1.0	0.9	-1.8	-25.9	26.6
Transport Equipment	0.4	0.0	-0.3	12.7	-0.8	-6.4
Imports, %yoy				-13.6	-13.3	25.0

Source: CEIC and Deutsche Bank

We do not want to draw any hasty conclusion based on the trade data of the last 6-9 months, as this was a period marked by disruption owing to demonetization and GST and the trend therefore can change materially, once the economy stabilizes completely. But it is worth highlighting the divergence, as it can have impact on growth going forward, if the trend reverses (imports slowing down and exports picking up).

*** The likely impact of complying with Export Data Processing and Monitoring System.** This brings us to the final part of the discussion about why exports may have slowed down substantially in May-July period of this year, apart from any potential impact which may have to do with the implementation of GST from 1 July. We think part of the slowdown in exports momentum during the second quarter of 2017 has to do with the pressure faced by exporters to comply with the reconciliation of all export transactions in Export Data Processing and Monitoring System (EDPMS), an IT-platform which has been introduced with the objective to simplify the procedure for filling various returns and for better monitoring.

Prior to implementation of EDPMS, export related data and status of exports were not available at a single platform, making the monitoring process difficult. EDPMS strives to simplify the procedure for filling various returns related to export and facilitate the banks to report various returns to RBI through a single platform. In the system, the primary data on exports transactions including offsite software exports from all the sources viz. Customs/SEZ/STPI flow to RBI secured server and the same is available with the respective banks for follow up with the exporters.

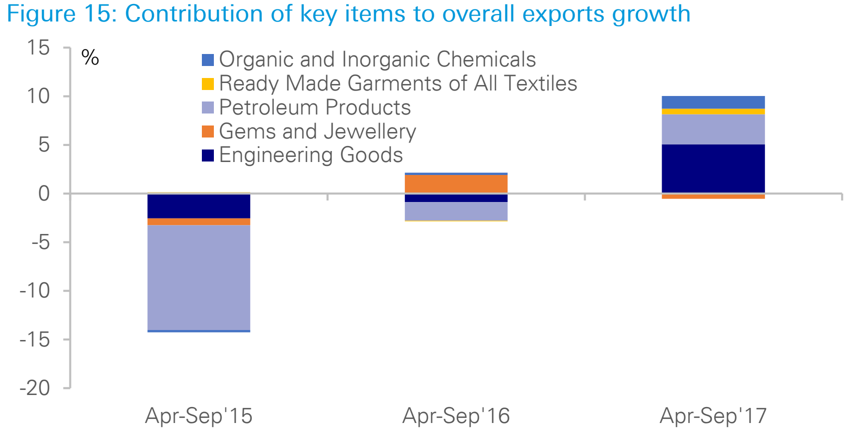
The deadline for reconciliation of all export transactions have been pushed forward many times in the past and this year the deadline was set for 30th April, which may have led to slowdown in exports activity in the subsequent months, even though the April deadline was subsequently pushed forward once again. Apart from petroleum exports, we note that only engineering goods and chemical exports have contributed materially to overall exports growth during April-Sep'17, while gems & jewellery and drugs & pharmaceuticals have subtracted from growth.

Figure 14: Contribution of top 10 items to export growth

	Contribution to Exports			%yoy		
Key Exports	Apr-Sep'15	Apr-Sep'16	Apr-Sep'17	Apr-Sep'15	Apr-Sep'16	Apr-Sep'17
Engineering Goods	-2.5	-0.9	5.1	-11.3	-3.7	21.3
Gems and Jewellery	-0.7	1.9	-0.6	-5.7	13.1	-3.3
Petroleum Products	-10.8	-1.9	3.1	-51.0	-15.1	28.3
Ready Made Garments of All Textiles	0.1	-0.1	0.6	2.3	-1.3	8.7
Organic and Inorganic Chemicals	-0.2	0.2	1.3	-5.5	4.4	25.2
Drugs and Pharmaceuticals	0.5	-0.1	0.0	10.0	-2.2	-0.7
Cotton Yarn, Fabrics, Madeups, Handloom Products etc	0.0	-0.4	0.2	-1.5	-9.6	4.3
Rice	-0.4	-0.2	0.7	-16.5	-10.2	29.5
Marine Products	-0.3	0.3	0.7	-16.0	18.4	34.1
Plastic and Linoleum	-0.2	0.0	0.2	-7.9	2.3	7.2
Exports, %yoy				-17.1	-3.0	11.5

Source: CEIC and Deutsche Bank

Figure 15: Contribution of key items to overall exports growth



Source: CEIC and Deutsche Bank

As the exports slowdown in May-July coincided with a sharp pickup in imports growth, ahead of the GST, net exports contributed substantially negative to growth and resulted in a sub-6% growth during April-June quarter, apart from other factors such as GST related de-stocking which pulled down growth. **In this regard, note that the reconciliation related to import transactions are likely to take place next year and there could be a period, when imports slow down sharply, resulting in net exports adding materially to overall growth.**

The April-June'17 growth outturn should therefore be seen as more of an aberration, pulled down by temporary disruption and technical factors. The economy has already started to stabilize post GST and high frequency indicators are showing a rebound, which should eventually reflect a recovery in July-Sep'17 GDP growth (DB estimate 6.4%), when the data is released on 30th November.

Figure 16: High frequency growth indicators - monthly trend

Real sector (% yoy)	Jan-17	Feb-17	Mar-17	Apr-17	May-17	Jun-17	Jul-17	Aug-17	Sep-17	Oct-17
Industrial production	3.5	1.2	4.4	3.2	2.9	-0.2	0.9	4.3	4.8*	
Core infrastructure production	3.4	0.5	5.2	2.6	3.9	1.0	2.6	4.4	5.2	
Manufacturing PMI	50.4	50.7	52.5	52.5	51.6	50.9	47.9	51.2	51.2	50.3
Services PMI	48.7	50.3	51.5	50.2	52.2	53.1	45.9	47.5	50.7	
Composite PMI	49.4	50.7	52.3	51.3	52.5	52.7	46.0	49.0	51.1	
Auto sales	-5.1	2.4	2.9	9.5	9.6	1.8	12.0	13.5	10.3	
Exports	5.1	22.5	27.2	17.9	7.5	3.7	3.0	10.3	25.7	

*Source: CEIC, Deutsche Bank. Note: * denotes DB forecast*

Growth and elections

We forecast a sequential recovery in growth from July-Sep'17 quarter, with the momentum improving further in 2HFY18, as the base effect turns positive and pent-up demand starts reflecting in higher private consumption growth (56% of GDP). **While we expect growth to average around 6.6% during FY18, we are more optimistic about the outlook for FY19 and beyond.**

The government has been taking proactive steps to deal with the problem areas in GST, and the positive impact of the landmark tax reform is likely to start getting reflected from the next fiscal year, in our view. The ongoing NPA resolution and the front loaded bank-recapitalization programme are likely to lead to an improvement in credit disbursal by public sector banks, mainly to the small and medium enterprises (SMEs), which are one of the key engines of growth in the current economic structure. Finally, the government's push toward affordable housing and its consequent multiplier impact will also likely add incrementally to growth. A stagnation in global growth recovery and/or higher global oil prices remain key risk to our baseline forecast of growth improving to 7.5%yoy in FY19, from about 6.6% likely in this fiscal year.

Apart from these factors, we also note that growth momentum generally improves in the year prior to the elections (India's next general elections are to be held in May 2019 or earlier), a trend which is likely to play out in this cycle as well. With the exception of 2008, given the Global Financial Crisis, growth momentum typically has improved one year prior to the election period, thereafter accelerating further during the election year and the year after. We think given the various reforms that are operational at this stage and that have been implemented by this government so far, it is reasonable to expect growth to return close to 8.0% by FY20, absent any external shock that could jeopardize this baseline outlook.

Figure 17: Growth and elections - an event study

Time period	Election year	Financial year	Real GDP growth (%yoy)
T - 2	2002	FY03	3.9
T -1	2003	FY04	7.9
Election	2004	FY05	7.8
T+1	2005	FY06	9.3
T - 2	2007	FY08	9.8
T -1	2008	FY09	3.9
Election	2009	FY10	8.5
T+1	2010	FY11	10.3
T - 2	2012	FY13	5.5
T - 1	2013	FY14	6.4
Election	2014	FY15	7.5
T+1	2015	FY16	8.0
T - 2	2017	FY18F	6.6
T - 1	2018	FY19F	7.5
Election	2019	FY20F	7.8
T+1	2020	FY21F	8.0

Source: Election Commission of India, Deutsche Bank. Note 1: T -2 denotes two years prior to the election, T +1 denotes one year post election. Note 2: "F" refers to Deutsche Bank forecasts.

Political snapshot

Figure 18: Percentage of seats held by Political Parties in Lok Sabha (LS) and Rajya Sabha (RS)

	Lok Sabha	Rajya Sabha	% of total seats in LS	% of total seats in RS
National Democratic Alliance (NDA)	**338**	**85**	**62.0%**	**34.7%**
BJP	281	57	51.6%	23.3%
Allies	57	28	10.5%	11.4%
United Progressive Alliance (UPA)	**49**	**63**	**9.0%**	**25.7%**
Congress	45	57	8.3%	23.3%
Allies	4	6	0.7%	2.4%
Others	155	94	28.4%	38.4%
Vacant	3	3	0.6%	1.2%
Total	**545**	**245**	**100%**	**100%**

Source: Lok Sabha and Rajya Sabha, Deutsche Bank. Note: The key allies of BJP are Shiv Sena, Telegu Desam Party, Janata Dal (United), Lok Janshakti Party, Shiromani Akali Dal, J&K People's Democratic Party, Rashtriya Lok Samata Party and Apna Dal.

Figure 19: State-wise allocation of Rajya Sabha (RS) seats

States	No. of seats	% of total RS seats	States	No. of seats	% of total RS seats	States	No. of seats	% of total RS seats
Andhra Pradesh	11	4.5%	Jharkhand	6	2.4%	Odisha	10	4.1%
Arunachal Pradesh	1	0.4%	Karnataka	12	4.9%	Puducherry	1	0.4%
Assam	7	2.9%	Kerala	9	3.7%	Punjab	7	2.9%
Bihar	16	6.5%	Madhya Pradesh	11	4.5%	Rajasthan	10	4.1%
Chhattisgarh	5	2.0%	Maharashtra	19	7.8%	Sikkim	1	0.4%
Goa	1	0.4%	Manipur	1	0.4%	Tamil Nadu	18	7.3%
Gujarat	11	4.5%	Meghalaya	1	0.4%	Telangana	7	2.9%
Haryana	5	2.0%	Mizoram	1	0.4%	Tripura	1	0.4%
Himachal Pradesh	3	1.2%	Nagaland	1	0.4%	Uttar Pradesh	31	12.7%
Jammu and Kashmir	4	1.6%	NCT Delhi	3	1.2%	Uttarakhand	3	1.2%
						West Bengal	16	6.5%

Source: Rajya Sabha, Deutsche Bank

Figure 20: Election calendar

State	Last election	Next election	Ruling party	RS seats	% of RS seats	State	Last election	Next election	Ruling party	RS seats	% of RS seats
Gujarat	Dec-12	Dec-17	BJP	11	4.5%	Andhra Pradesh	Apr-May-14	May-19	TDP	11	4.5%
Himachal Pradesh	Nov-12	Nov-17	INC	3	1.2%	Arunachal Pradesh	Apr-14	May-19	BJP	1	0.4%
Chhattisgarh	Nov-13	Nov-18	BJP	5	2.0%	Haryana	Oct-14	Oct-19	BJP	5	2.0%
Karnataka	May-13	May-18	INC	12	4.9%	Jammu & Kashmir	Nov-Dec-14	Nov-Dec-19	BJP+PDP	4	1.6%
Madhya Pradesh	Nov-13	Nov-18	BJP	11	4.5%	Jharkhand	Nov-Dec-14	Nov-Dec-19	BJP	6	2.4%
Meghalaya	Feb-13	Feb-18	INC	1	0.4%	Maharashtra	Oct-14	Oct-19	BJP	19	7.8%
Mizoram	Nov-13	Nov-18	INC	1	0.4%	Odisha	Apr-14	Apr-19	BJD	10	4.1%
Nagaland	Feb-13	Feb-18	NPF	1	0.4%	Sikkim	Apr-14	Mar-19	SDF	1	0.4%
NCT Delhi	Dec-13	Dec-18	AAP	3	1.2%	Telangana	Apr-14	May-19	TRS	7	2.9%
Rajasthan	Dec-13	Dec-18	BJP	10	4.1%	Bihar	Nov-15	Nov-20	JD(U)+BJP	16	6.5%
Tripura	Feb-13	Feb-18	CPI (M)	1	0.4%	General Elections	Apr-May-14	May-19	BJP		

Source: Election Commission of India, Deutsche Bank

Figure 21: Names of key political parties (in alphabetical order)

1	AAP: Aam Aadmi Party	8	JD (S): Janata Dal (Secular)
2	AIADMK: All India Anna Dravida Munnetra Kazhagam	9	JD (U): Janata Dal (United)
3	AITC: All India Trinamool Congress	10	PDP : Peoples Democratic Party
4	BJD: Biju Janata Dal	11	SAD: Shiromani Akali Dal
5	BJP: Bharatiya Janata Party	12	SP: Samajwadi Party
6	CPI (M): Communist Party of India (Marxist-Leninist)	13	TDP: Telegu Desam Party
7	INC: Indian National Congress	14	UDF: United Democratic Front

Source: Election Commission of India, Deutsche Bank

Data, forecast, and charts

Figure 22: National accounts: production and expenditure side GDP

% yoy, real	FY14/15	FY15/16	FY16/17	FY17/18F	FY18/19F
Gross value added	7.2	7.9	6.6	6.6	7.5
Agriculture	-0.2	0.7	4.9	2.6	3.0
Industry	8.6	10.2	7.0	4.6	7.3
Services	8.9	9.1	6.9	8.3	8.6
Expenditure side GDP	**7.5**	**8.0**	**7.1**	**7.0**	**7.5**
Consumption exp.	6.7	5.7	10.5	8.3	8.4
Private	6.2	6.1	8.7	7.6	8.1
Government	9.6	3.3	20.8	11.9	9.8
Investment	3.4	6.5	2.4	3.3	5.0
Exports	1.8	-5.3	4.5	1.9	6.8
Imports	0.9	-5.9	2.3	3.9	6.2

Source: CSO, CEIC, Deutsche Bank forecasts

Figure 23: Fiscal operations

% of GDP	FY14/15	FY15/16	FY16/17	FY17/18F	FY18/19F
Central government balance	**-4.1**	**-3.9**	**-3.5**	**-3.2**	**-3.0**
Government revenue	9.3	9.3	9.8	9.5	10.0
Government expenditure	13.4	13.2	13.4	12.7	13.0
Central primary balance	-0.9	-0.7	-0.3	-0.1	0.0
Consolidated deficit	**-6.6**	**-6.5**	**-6.5**	**-6.2**	**-6.0**
memo					
Central	**-4.1**	**-3.9**	**-3.5**	**-3.2**	**-3.0**
State	-2.5	-2.6	-3.0	-3.0	-3.0
Debt/GDP	70.3	70.4	70.0	69.0	67.5

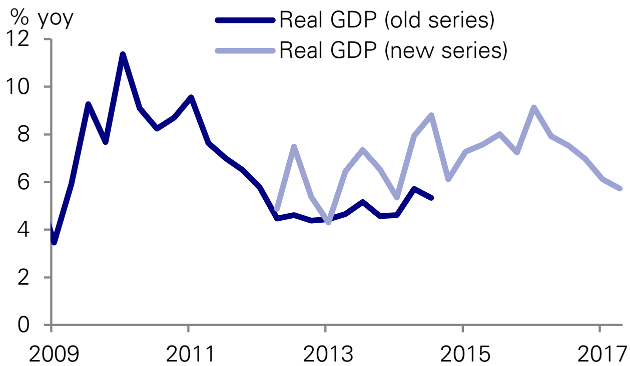
Source: Controller General of Accounts, Government of India, Deutsche Bank forecasts

Figure 24: Balance of Payments

USD bn	FY14/15	FY15/16	FY16/17	FY17/18F	FY18/19F
Exports	316.5	266.4	280.1	302.9	320.8
Imports	461.5	396.4	392.6	438.5	464.7
Trade account	-144.9	-130.1	-112.4	-135.6	-143.9
% of GDP	-7.1	-6.2	-5.0	-5.2	-5.0
Invisibles, net	118.2	108.0	97.2	102.1	100.6
% of GDP	5.8	5.2	4.3	3.9	3.5
Current account	**-26.7**	**-22.1**	**-15.2**	**-33.5**	**-43.3**
% of GDP	-1.3	-1.1	-0.7	-1.3	-1.5
Capital account	89.2	41.1	36.4	83.9	67.1
% of GDP	4.4	2.0	1.6	3.2	2.3
Overall BOP	61.4	17.9	21.6	50.4	23.8

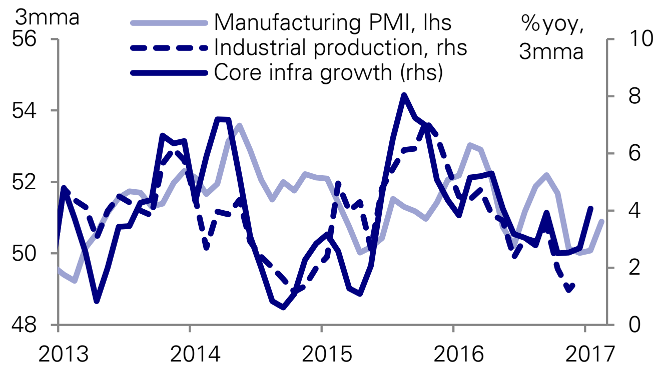
Source: RBI, CEIC, Deutsche Bank forecasts

Figure 25: Real GDP growth moderated further to 5.7% in April-June'17, due to GST-related de-stocking



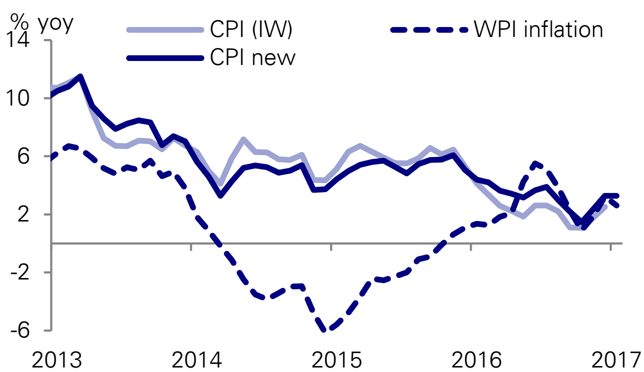
Source: CEIC, CSO, Deutsche Bank

Figure 26: Industrial sector growth momentum reflects a gradual and uneven recovery



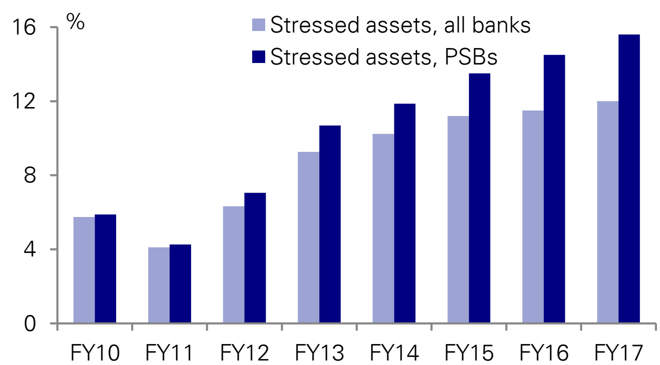
Source: CEIC, Bloomberg Finance LP, Deutsche Bank

Figure 27: CPI and WPI inflation bottomed in June; likely to inch up slightly above 4% by March'18



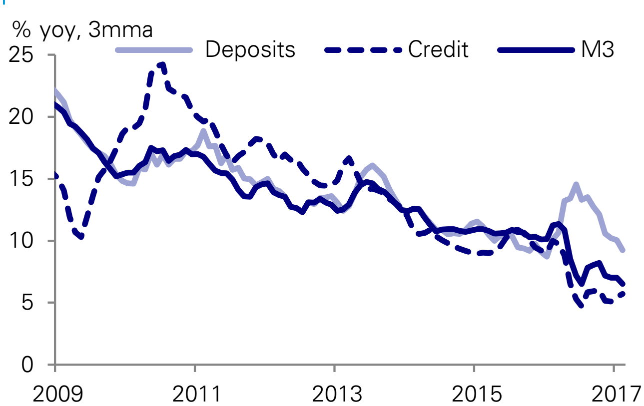
Source: CEIC, RBI, Deutsche Bank. Note: IW denotes industrial workers

Figure 28: Public sector bank's stressed assets (NPAs + restructured assets) have risen significantly



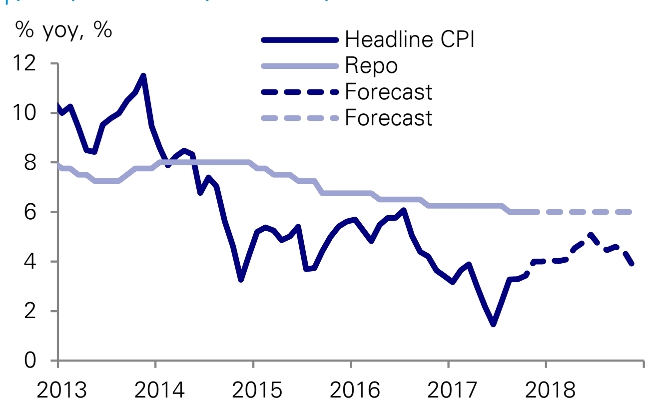
Source: RBI, Deutsche Bank

Figure 29: Credit growth remains weak, as banks are reluctant to lend in an environment of elevated NPAs



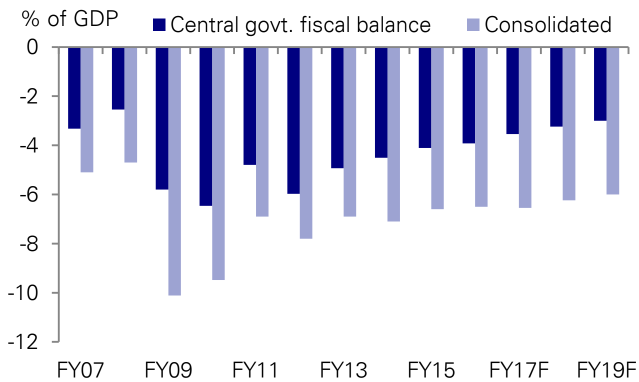
Source: CEIC, RBI, Deutsche Bank

Figure 30: RBI eased the repo rate by 25bps in August policy; extended pause likely



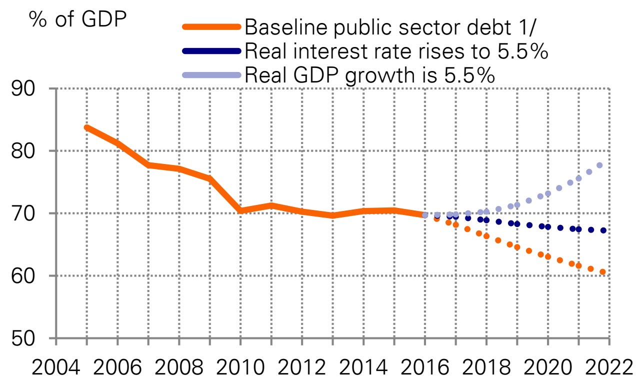
Source: CEIC, RBI, Deutsche Bank

Figure 31: The plan is to bring the centre's fiscal deficit down to 3.0% of GDP by FY19; FY18 target is 3.2%



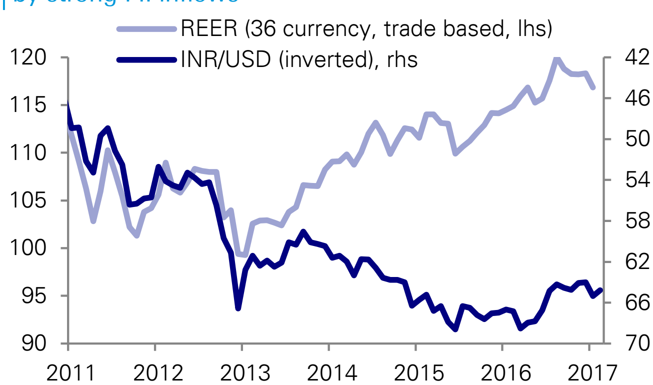
Source: CEIC, Budget documents, Deutsche Bank

Figure 32: Considerable vulnerability to a rise in real interest rate and low GDP growth



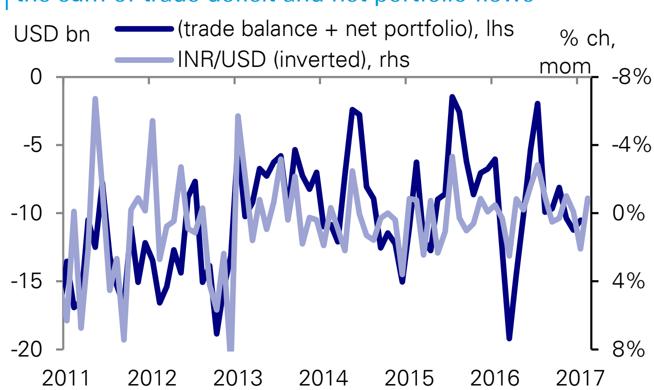
Source: Government of India, Deutsche Bank. 1/ Combined Central and State level debt

Figure 33: INR/USD has appreciated sharply in 2017, led by strong FII inflows



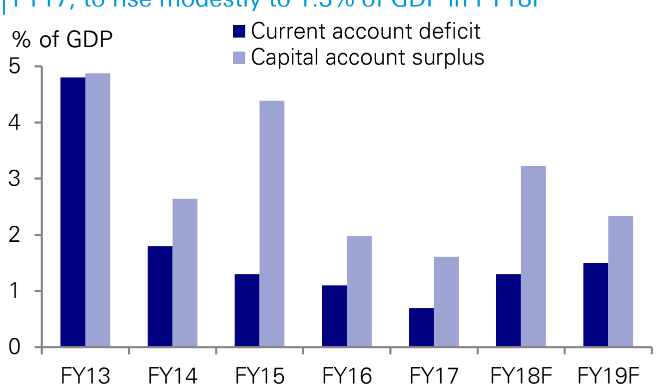
Source: CEIC, RBI, Deutsche Bank

Figure 34: Rupee's movement is closely interlinked with the sum of trade deficit and net portfolio flows



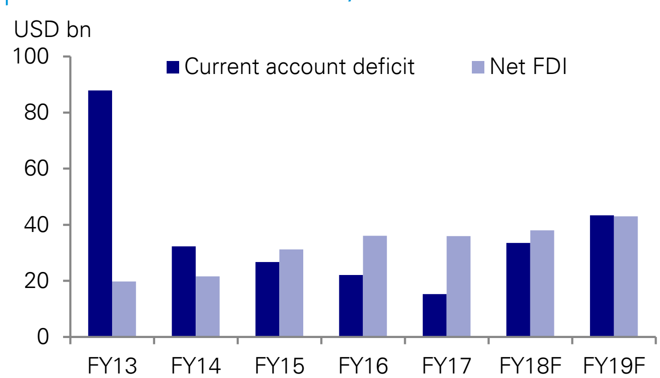
Source: CEIC, RBI, Deutsche Bank

Figure 35: Current account deficit was 0.7% of GDP in FY17; to rise modestly to 1.3% of GDP in FY18F



Source: CEIC, RBI, Deutsche Bank estimates

Figure 36: Net FDI on its own should be able to fund the current account deficit in the years ahead



Source: CEIC, RBI, Deutsche Bank Forecasts

Figure 37: Catalogue

The author of this report wishes to acknowledge the contribution made by Daisy Sharma and Mahesh Kumar Bukka in preparation of this report.

Appendix 1

Important Disclosures

*Other information available upon request

*Prices are current as of the end of the previous trading session unless otherwise indicated and are sourced from local exchanges via Reuters, Bloomberg, and other vendors. Other information is sourced from Deutsche Bank, subject companies, and other sources. For disclosures pertaining to recommendations or estimates made on securities other than the primary subject of this research, please see the most recently published company report or visit our global disclosure look-up page on our website at http://gm.db.com/ger/disclosure/DisclosureDirectory.eqsr. Aside from within this report, important conflict disclosures can also be found at https://gm/db.com/equities under the "Disclosures Lookup" and "Legal" tabs. Investors are strongly encouraged to review this information before investing.

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Macroeconomic fluctuations often account for most of the risks associated with exposures to instruments that promise to pay fixed or variable interest rates. For an investor who is long fixed rate instruments (thus receiving these cash flows), increases in interest rates naturally lift the discount factors applied to the expected cash flows and thus cause a loss. The longer the maturity of a certain cash flow and the higher the move in the discount factor, the higher will be the loss. Upside surprises in inflation, fiscal funding needs, and FX depreciation rates are among the most common adverse macroeconomic shocks to receivers. But counterparty exposure, issuer creditworthiness, client segmentation, regulation (including changes in assets holding limits for different types of investors), changes in tax policies, currency convertibility (which may constrain currency conversion, repatriation of profits and/or the liquidation of positions), and settlement issues related to local clearing houses are also important risk factors to be considered. The sensitivity of fixed income instruments to macroeconomic shocks may be mitigated by indexing the contracted cash flows to inflation, to FX depreciation, or to specified interest rates – these are common in emerging markets. It is important to note that the index fixings may -- by construction -- lag or mis-measure the actual move in the underlying variables they are intended to track. The choice of the proper fixing (or metric) is particularly important in swaps markets, where floating coupon rates (i.e., coupons indexed to a typically short-dated interest rate reference index) are exchanged for fixed coupons. It is also important to acknowledge that funding in a currency that differs from the currency in which coupons are denominated carries FX risk. Naturally, options on swaps (swaptions) also bear the risks typical to options in addition to the risks related to rates movements.

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