A Macroeconomic Overview 2009

ECONOMIC SNAPSHOT

INDIA

Q S Consultants India Pvt. Ltd.

INTRODUCTION

Established in February 2008, Q S Consultants was conceptualized as a consultation firm providing advisory services in the Travel & Tourism, Infrastructure and Sustainable Business Practices Areas, bringing dedicated expertise and an imaginative approach to meet the demands of an industry in the midst of rapid transition and offer well-defined and executable strategies to achieve business objectives.

Helping you make the

right choice

Indian Economy in 2008-2009

2008-09 has been a chaotic year both globally and nationally. Amidst a high degree of uncertainty, India's economic forecast has transformed continuously with the changing global scenario. The table below reflects India's performance at the end of the 2008-09 after a series of estimate revisions, both by government and independent sources.

Table 1: Macroeconomic Snapshot (2008-09)

GDP at Factor Cost (current prices)	Rs. 49,89,804 cr
GDP at Factor Cost (constant prices-1999-2000)	Rs. 33,51,653 cr
Composition of GDP	Services: 57%
	Industry: 26%
	Agriculture: 17%
Industrial growth (IIP)	3% (Apr 08–Jan 09) LY 8.5%
Per Capita Income	Rs. 38,084
Core Infrastructure growth	3.2% (Apr 08 – Jan 09) LY 5.7%
Annual Inflation (WPI)	0.44% (Mar 07,2009) LY 7.78%
Broad Money (M3) growth (y-o-y)	19.9% (Feb 13, 2009) LY 21.6%
Forex Reserves	US $ 238.7 billion (Feb 28,2009)
Cumulative amount of FDI inflows	US$ 18.70 billion/Rs 80,395 cr (Apr- Oct 2008)
Exchange rate INR/1 USD	49.26/ US$; 70.83/ GBP
Food grain stocks	35.79 million tonnes (Jan 01, 2009)
Exports	US$ 144,266 million/ Rs. 645,572 crore (Apr 08 – Jan 09) 13.2% growth
Imports	US$ 243,358 million/Rs.1,090,182 crore (Apr 08 – Jan 09) 25.3% growth

Sources: Ministry of Finance (Dept. Of Economic Affairs) Jan 2009 Economic Update

Sectoral Snapshot

Increased contribution from services has been mirrored by a decrease in agriculture and manufacturing.

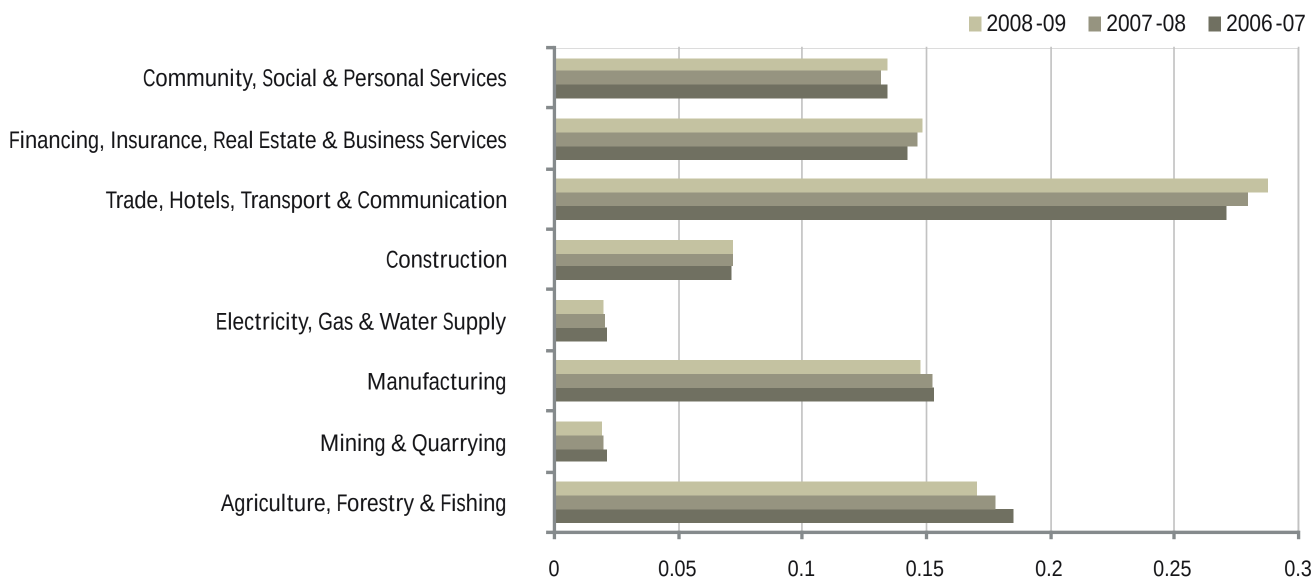


Figure 1: Trends in Economic Activity 2006-07 to 2008-09

- Agriculture contributes barely 1/3 of the GDP compared to it's earlier 50%+ contribution. It supports more than 5mn people and provides livelihood to 52% of India's workforce. The rural market accounts for 65%+ of India's population and over 50% of total consumption. **Hence, development of the agro sector should be recognised as an equal thrust area so that production by manufacturing or services sectors are consumed by the country leading to true organic growth in GDP and economy. That's what we call sustainable economic development.**

- Services continue to be the main contributor to GDP with an input of 57% in 2008-09. **Within this sector, "trade, hotels, transport and communication" alone contributed 29% of the GDP.**

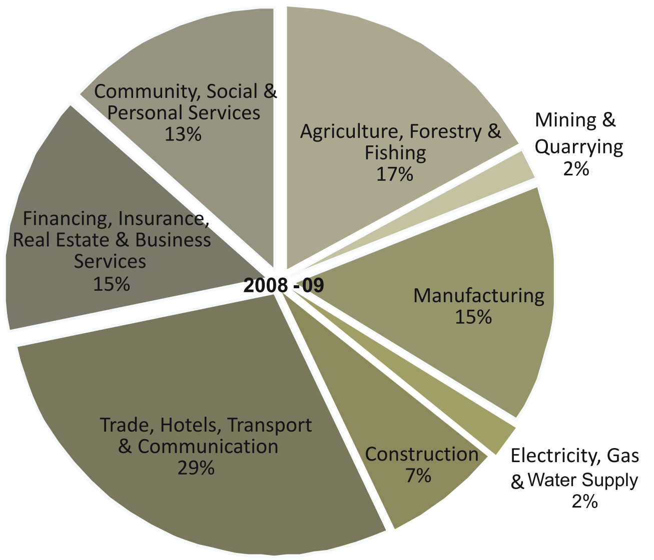


Figure 2: GDP by Economic Activity - 2008-09

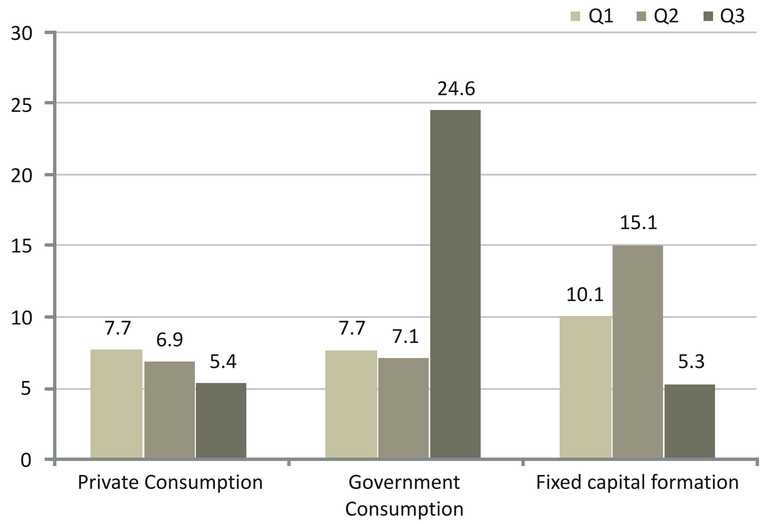


Figure 3: Year on Year growth for FY 2008-09 (in %)

- Agriculture accounted for 17% of the gross domestic product (GDP), while industry contributed 26% of the gross domestic product (GDP). Within the industrial sector, manufacturing contributed a significant 15% despite slowing consumption, investment and exports.
- Government expenditure increased H2 2008-09. **Subsidies (81%) were the biggest contributor.** The fall in investment reflects increased expenditure to sustain consumption at the cost of infrastructure.
- **Government spending and unsold goods contributed 48% in GDP in Q3 .** The government's total expenditure contributed 44% to GDP at market prices, less discrepancies.
- An over cautious spending approach and the intention to hedge in response to the world economy, led to a slowing down of private consumer spending in tandem.
- Gross fixed capital formation was 33.4%; private consumption expenditure was 58.5%; imports less exports (-6.2%); changes in stocks 4.3% and changes in valuables 1.2%.

Key Economic Trends

- The projections for the growth rate of 7.1% in GDP during 2008-09 has mainly been due to 2.6% growth in Agriculture, 4.8% in Industry and 9.6% in Services as compared to 4.9%, 8.1% and 10.9% respectively during 2007-08.

Table 2: Rate of Growth of GDP at Factor Cost by Economic Activity (percentage)

	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09
Agriculture, Forestry & Fishing	-7.2	10.0	-	5.9	3.8	4.9	2.6
Mining & Quarrying	8.8	3.1	8.2	4.9	5.7	3.4	4.7
Manufacturing	6.8	6.6	8.7	9.0	12.0	8.2	4.1
Electricity, Gas & Water Supply	4.7	4.8	7.9	4.7	6.0	5.3	4.3
Construction	7.9	2.0	16.1	16.5	12.0	10.1	6.5
Trade & Hotels	6.9	10.1	7.7	9.4	11.8	12.4	10.3
Transport & Communication	14.1	15.3	15.6	14.6			
Financing, Insurance, Real Estate & Business Services	8.0	5.6	8.7	11.4	13.9	11.7	8.6
Community, Social & Personal Services	3.9	5.4	6.9	7.2	6.9	6.8	9.3
GDP	*3.8*	*8.5*	*7.5*	*9.4*	*9.6*	*9.0*	*7.1*

Sources: Advance Estimates of National Income 2008-09 & 2007-08 (CSO); Economic Survey of India (2007-08) & Interim Union Budget of India 2008-09

- Major contributors were the service sector and construction with growth rates over 5%. However, sectors not linked directly with the domestic economy have shown drastically reduced growth over the last year. IT/ ITES, Outsourcing, Banking, Finance & Business Services, Retail and Real Estate continue to feel the impact of the global downturn.
- The growth in 'Community, Social and Personal Services' is due to an increase of governmental expenditure over the last few months of this fiscal year.
- India's economy has a domestic focus with domestic savings being a key growth driver. While the global downturn affected Indian equity and foreign exchange markets, the economy was relatively insulated by the overall strength of the domestic demand and the domestic nature of investment financing.
- Growth in services over the last few years has led to unsustainable growth as disposable incomes increased without corresponding increase in real output. Despite an increasing presence of multinationals, scaling up of operations by domestic companies and an expanding domestic market, manufacturing has shown a steady decline.

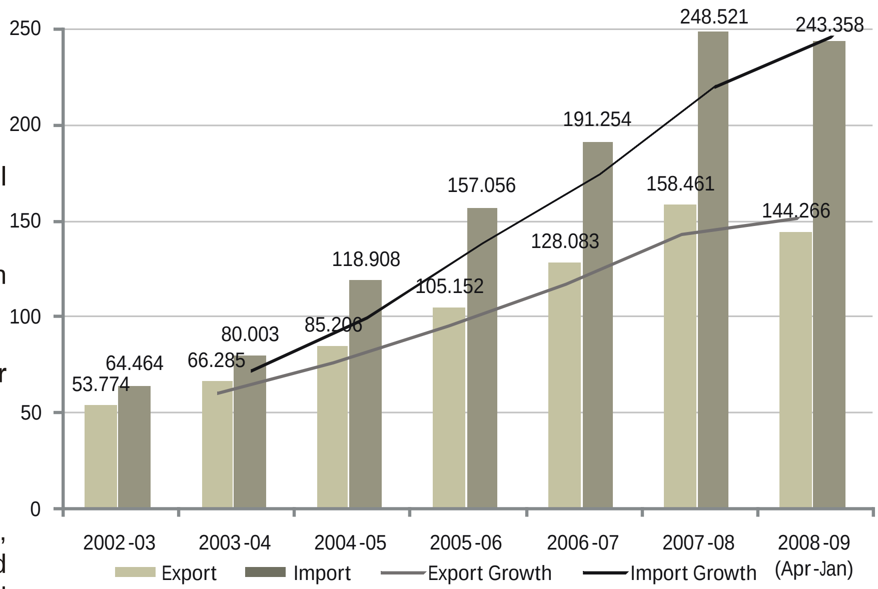
Sectors Pulling Up Export Growth

- Pharmaceuticals, Engineering Products, Agricultural Commodities Including Spices
- Increase In Exports 19-25%

Sectors Pulling Down Export Growth

- Gems & Jewellery, Textiles, Handicrafts, Handlooms And Chemicals
- Decrease in Exports: Handloom & Handicrafts (64%), Gems & Jewellery & Chemicals (21%), Textiles (13%)

- Global recession has impacted exports and the investments via reduced capital inflows. **Export growth has reduced from 23% (2008) to 13.2% (2009). India's cumulative value of exports for Apr 08 to Jan 09 was US$144,266mn.**
- For Apr'08- Jan '09, **imports registered a growth of 25.3% to US$ 243,358 mn.**



- The recent economic slump has aggravated the need for sectoral correction as over enthusiastic companies had to re-evaluate their plans realistically. This should result in levelling of output and consequent growth in real and not inflationary terms. **The projected growth rate for 2008-09 should be revised from the official 7.1% to anywhere between 5.8% to 6.8%.**
- The government stimuli (on 7th Dec 08, 2nd Jan 09 and 24th Feb 09) provided need based tax relief to boost demand and increased expenditure on public projects. The results indicated revival in key sectors like steel, cement, autos, food & beverages and railway freight, thus counter balancing the impact of the global recession.
- Strong rural demand is keeping India's economy afloat. Measures include spending on flagship and infrastructure programmes and steady hikes in MSPs for wheat and rice.

- Sustainable growth in India should be driven by infrastructure development with an emphasis on agriculture and industry. As NRI remittances and FDI's reduce significantly, domestic consumption and savings will drive demand. **We recommend this policy to harness the true potential of Indian economy while being a part of the increasingly connected global efforts to counter recession.**

- **We expect the economy to even out by the second half of the 2009-10 as the current sectoral corrections and economic stability is regained.**

Impact of the Global Economic Crisis: A Global View

- An over dependence on borrowed funds for consumer spending led to the collapse of the financial sector creating a negative impact on major banks. This was followed by a fall in major commodity and oil prices.

- Major affected sectors: IT/ITES, Financial Services, Real Estate and Heavy industries.

- World growth will fall to 0.5% (lowest since World War II) when measured in terms of purchasing power parity and to turn negative when measured in terms of market exchange rates in 2009.

- Global trade and output in the advanced economies will contract by 2% in 2009.

- Growth in emerging and developing economies will slow from 6.25% in 2008 to 3.25% in 2009, due to falling export demand and financing, lower commodity prices, and much tighter external financing constraints.

- In the advanced economies, inflation will decline from 3.5% in 2008 to a record low 0.25% in 2009, before edging up to 0.75% in 2010. In emerging and developing economies, inflation will subside to 5.75% in 2009 and 5% in 2010, down from 9.5% in 2008.

- Helped by continued efforts to ease credit strains as well as expansionary fiscal and monetary policies, the global economy is projected to experience a gradual recovery in 2010, with growth picking up to 3%. However, the outlook is highly uncertain, and the timing and pace of the recovery depend critically on strong policy actions.

Impact of the Global Economic Crisis: The Indian Context

- Reduction in liquidity due to the adverse financial market trends and a slowdown in exports led to stabilisation of domestic consumption.

- Major affected sectors: IT/ITES, Financial Services, Real Estate and Heavy industries.

- As per official government projections, India's growth rate is projected at 7.1% in 2009 and 7.0% in 2010, a six year low. The new figures are down on April 2008 forecasts of 8% and 8.5% respectively.

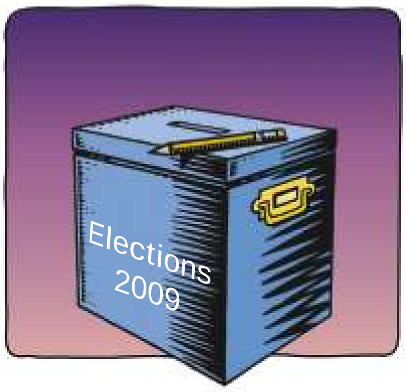
- Zero inflation is forecasted by end of March 2009. The sharp fall in Indian inflation is in tune with global price trends as slowing growth, lower equity, home prices and job losses have led consumers and companies to hold back on spending. Prices of commodities such as crude oil and steel have also tumbled from the multi-year highs in the middle of 2009.

India in 2009-10

- Real GDP to even out at around 6.7% in 2009-10.
- Industrial production will recover in 2009-10.
- The sectors to focus on are infrastructure, entertainment, telecom, FMCG and domestic tourism.
- Savings rate will increase as households will increase investments in instruments like life insurance, mutual funds and bullion.
- Trade deficit will rise as growth in imports continues to be faster than exports. Current deficit will rise as this will not be offset by higher invisible receipts (due to lower private transfers and service exports).
- Indirect fiscal measures will be used to revive the economy as the high fiscal deficit limits any direct fiscal stimulus.
- Further loan waivers for farmers, agriculture and related sectors will help them regain momentum as areas with the potential to attract investment for growth.
- While policy easing and low commodity prices revive the Indian economy, the focus now shifts to domestic demand and resurgence of agriculture, manufacturing and infrastructure as the key focal areas.
- Things to watch out for in 2009-10 are:
  (1) General Elections, (2) Domestic Demand and, (3) Slowing Remittances

15th Indian General Elections

- The world's largest democracy with a 714mn strong electorate heads for elections in 2009. The second largest democracy, USA, has an electorate of 210mn, roughly one-third of India. 43mn new voters were added to the electoral rolls since 2004.
- One of the first elections to reflect India's urbanisation over the last three decades, each urban vote will now be worth as much as a rural vote as the delimitation exercise changed the contours of 499 of 543 constituencies across the country. The delimitation also impacts the reach and control of existing parties and MPs over constituencies and their strategic importance.
- Key issues that will decide these elections are (1) Political Alliances (leadership groups), (2) Economic growth & unemployment (keeping in mind the current situation), (3) Infrastructure and (4) Terrorism.
- The most likely verdict of this election would be the return of a fractured coalition where the right alliances would decide government formation.



Domestic Demand

- India's exports (nearly $200bn) contribute only 20% of its domestic production. The economy is likely to remain domestic demand driven in the medium term.
- Private consumption emerges as a key driver of domestic demand. Changes in consumption tend to be gradual and steady, as any sharp changes in income get adjusted in the saving rate. Hence, a 2% reduction in income growth rate has seen a fall of 3% in domestic savings, but only a marginal change in private consumption.

- A reduction in domestic savings (due to contracting values of physical and financial assets of households) and deferred capital expenditure (decrease in corporate profits) will lead to moderation in investment.
- Domestic demand is expected to receive a boost once government and RBI polices start to kick in.

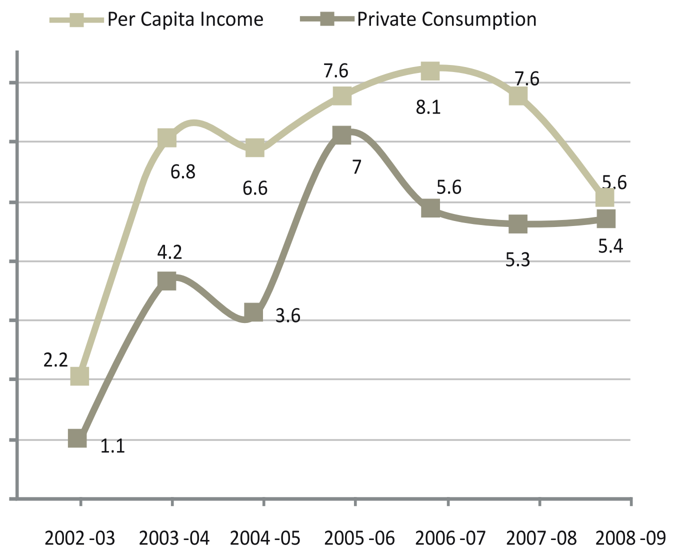


Figure 5: Growth trends (%) in Per Capita Income & Private Consumption

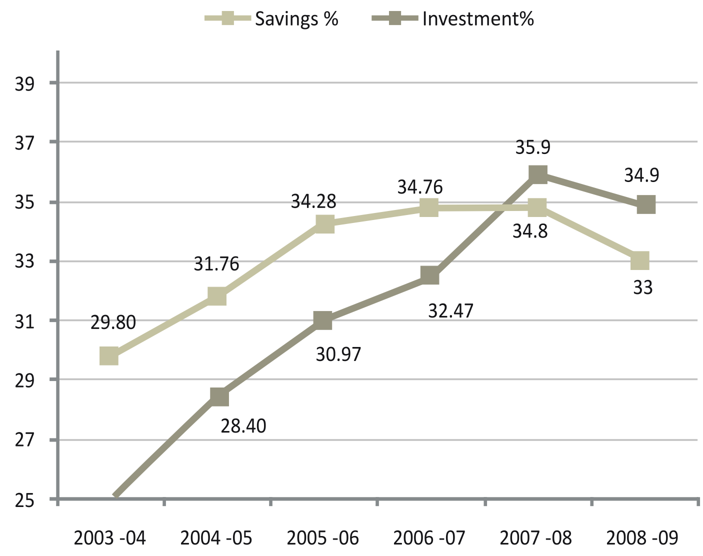


Figure 6: Savings & Investment Trends (%)

RBI Policies

In early March 2009, RBI finally cut its repo rate to 5% and the reverse repo rate to 3.5%. The policy encourages banks to lend to earn more instead of earning 3.5% by keeping their excess cash with the RBI. Lower interest rates are expected to spur demand for loans, and encourage consumers to spend and firms to invest. The rate cut will have an adverse impact on rupee value as a fall in return will discourage overseas investors from buying Indian assets.

We do not recommend any further decrease in repo rate as it is essential to attract foreign money at a time when investors are cautious of how they invest their funds due to the western meltdowns and defaults.

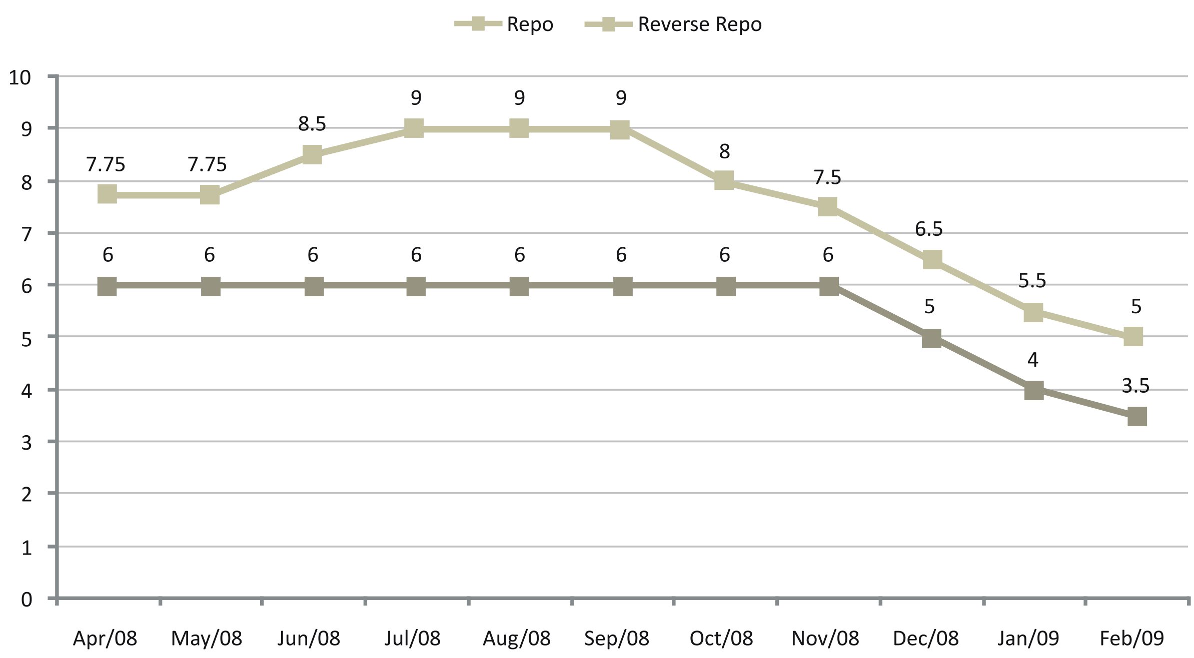


Figure 7: Repo Rate and Reverse Repo Rate Trends 2008-09

Government Stimulus Packages

The government announced three stimulus packages over Q4 2008-09 to counter the crisis faced due to the economic downturn.

First Stimulus Package (7th December 2008)	Second Stimulus Package (2nd January 2009)	Third Stimulus Package (24th February 2009)
- Additional spending of Rs. 20,000 cr. In the next four months. - Cenvat slashed by 4%; excludes petroleum products - Tax and liquidity sops for labour-intensive exports such as textiles - Package for small scale sector to double limit for collateral-free funding to Rs 1 cr. - Import duties on naphtha for power production abolished - Excise duty on cotton textiles removed	- Central bank cuts key rate by 1% - ECB norms relaxed - FII limit in corporate bonds more than doubled - New lines of credit for NBFCs, exporters - Additional Rs. 30,000cr refinance by IIFCL - States allowed to borrow an extra Rs. 30,000 cr - JNNURM funds to be used to acquire buses; tax benefits to promote Cvs - States encouraged to release land for low-cost houses - Protection for select sectors against imports	- Cenvat rate slashed by 2% to 8% - Reduction in service tax 2% to 10% - Amendment of Section 10 AA of the IT Act to provide consistent tax benefits for all entities operating in special economic zones - 4% excise duty cut to be continued beyond 31 March 2009 - Excise duty on bulk cement to be 8% or Rs. 230 per metric tonne whichever is higher - Naphtha for power production exempted from custom duty

These measures will balance out the impact of burden of international monetary crisis to some extent as it will encourage more liquidity into the market while leaving more money in the hands of corporate India leading easing out of money circulation.

Slowing Remittances

- In 2007, India was one of the largest remittance recipients (with China and Mexico) totalling to US$27bn. Remittances tend to be more stable and countercyclical compared to private capital and official inflows. USA (44%) is the single largest contributor to Indian remittances followed by the Middle East (23%).
- Inward remittances (private transfers) play a key role in balancing India's trade deficit. In 2007-08, private transfers formed 56% of net invisibles and 51% of the total trade balance.

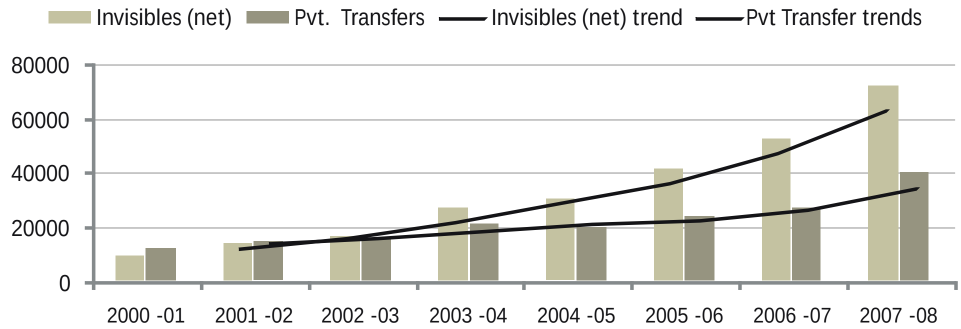


Figure 8: Net Invisibles vs. Private Transfers (in US$mn)

- Remittances in India largely augment household income (50%+) but are also invested in land/ property (10%) and bank deposits (20%).
- Private transfers have seen a marked reduction as a result of the global economic meltdown as NRIs face income insecurity.
- Sustainable remittance inflows can be facilitated by increasing interest rates on NRI deposits (as evidenced by the increase of 12-21 basis points on US$ deposits by the SBI in Mar 09), introduction of special NRI deposits and reduction in remittance costs.

Future Growth Drivers

- **Investments:** Investments grew by 33% y-o-y in Q3 2008-09 ending at Rs. 291,468 cr. **Investment growth is expected to fall drastically** as higher capital costs, longer working capital cycles, falling demand and limited funding takes it's toll.

- **Consumption:** While household debt levels remain stable at 10.5%, aggregate consumption is expected to improve slightly as **fiscal measures and lower interest rates begin to boost confidence and stimulate demand in latter half of 2009-10**.

- **Rural Markets:** Rural India demonstrated better consumption stability relative to the urban markets. However falling agro prices, as a result of the global economic meltdown could cause concern. **We recommend that investments in this sector can result in higher ROI due to subdued sentiments of farmers resulting from the gloomy economic scenario.**

Sectors Driving Growth forward...

- There is a need to focus on driving consumption through a sustainable increase in domestic demand, particularly from semi-urban and rural areas.
- Existing supply to shift towards domestic demand reflecting the need for affordable commodities and value for money
- A need to focus on the primary and secondary sectors contributing to GDP growth, agriculture & manufacturing, to create stability as basic consumption is unavoidable
- Sectors to focus on:
  - **Infrastructure**
  - **Tourism**
  - **Media & Entertainment**
  - **FMCG**
  - **Telecom**
  - **Consumer Durables**

Infrastructure

- Infrastructure accounts for 26.68% of India's industrial output and registered a growth of 3.5% during Apr-Dec 08 in the six core infrastructure industries against 5.9% during the corresponding period of the previous year.
- Adequate infrastructure development is critical for sustainable and inclusive growth momentum. Reduction of infrastructure deficit can help sustain growth in production sectors and also be “the driver of growth and employment” through its multiplier effects.
- The growth of physical infrastructure will help to overcome some of the supply-side constraints over production, and also stimulate domestic demand for goods and services that is essential for growth.
- The total number of approved PPP projects stands at 101 with an estimated combined cost of at least Rs. 10bn and include 88 highway projects, nine ports projects, two airport projects and one each in tourism infrastructure and railways.
- The government will increase spending on infrastructure to 9% of the gross domestic product in the five years ending 31 March 2012, from 5%. It will invest Rs14,000 cr to revive some state-controlled companies.
- The 123 agreement with US as well as agreements with other countries has augmented India's capacity to generate nuclear power.

- Exploration of oil fields at various locations across the vast coastline.

Tourism

- The decline in foreign tourism is evidenced by a sharp decline in both foreign tourist arrivals and forex earnings.
- The y-o-y foreign tourist arrivals fell to 5.02 lakh in Feb 09 (5.61 lakh in Feb 08), but improved over Jan 09 (4.87 lakh).
- Y-o-y forex earnings reduced to Rs. 4547 cr in Feb 09 (Rs. 5182 cr in Feb 08). Forex earnings in US$ was $923mn in Feb 09 ($1305mn in Feb 08).
- The lower growth rate in Feb 09 compared to Feb 08 resulted as tourism slowed worldwide due to global recession and resulting exchange rate variations.

- Domestic tourism has the potential to boost economic growth in India. Through it's direct and multiplier effects, it can contribute to employment generation, economic development and growth of areas like medical tourism.
- Vacation tourism will grow primarily through domestic movements creating a good opportunity for development of motels / highway lodges. As the tastes of Indian travellers has been experiencing an upward learning curve, the vacationers are willing to shell out more for a comfortable stay which provides for the sustenance of development in this sector.

  Religious tourism presents avenues for growth as more people demand comfort and hygiene rather than keeping their travel limited to a mere trip to the destination and back.
- Medical tourism emerges as one of the new niche areas evolving in India. With the availability of world class doctors and medical and ayurveda facilities at half the cost, India has been attracting people from across the world. According to a study by McKinsey and the Confederation of Indian Industry (CII), medical tourism in India could become a US$ 2 billion industry by 2012 (from US$ 350 million in 2006). Credit Suisse estimates medical tourism to be growing at about 25-30 per cent annually.
- Eco-tourism endeavours to encourage and support the diversity of local economies for which the tourism-related income is important. Eco-tourism is considered the fastest growing market in the tourism industry, according to the World Tourism Organization with an annual growth rate of 5% worldwide and representing 6% of the world gross domestic product, 11.4% of all consumer spending.
- With land prices coming down and a huge opportunity for quality hotels in India, there is an opportunity for investors to announce new projects in India. Investors in hotels need to have a long-term view of India. Most properties will become operational only around 2012 by which time the market is expected to bounce back.

Media & Entertainment

- Television, radio and events are an essential social requirement both in urban and rural India.
- The existing global recession necessitates cautious investment decisions by the media and entertainment (M&E) industry. While the industry reflects a growth rate of 7% in 2009, it is expected to grow at 10% in 2010. Information technology (IT) spending by the M&E industry is expected to grow to Rs 1,440 cr by 2010, with a compound annual growth rate of 32%. However, the annual growth will slow down to 23% in 2009 compared to 30% in 2008, but will pick up again in 2010.
- Technology has brought DTH and digital cinema to India thereby transforming content delivery as well as viewership experience. Companies are increasingly transforming from production towards content creation. FY 2009-10 will see new applications and ways of building the business. Outsourcing will find its place in the M&E sector where production and printing practices will be given to a third party and content generation, distribution, etc, will be home grown.

- As foreign film companies make forays into India and the indigenous industry continues a stable growth pattern, this is a good time for long term investments in this sector.

FMCG

- Despite continued job insecurity, consumption of FMCGs continued with relatively lower impact, mostly driven by domestic demand from insulated urban and rural segments in India.
- FMCG industry is projected to grow by 16% to Rs95,150cr during 2008-09, up from Rs85,470cre in the last fiscal year, amidst rising raw material prices. FMCG growth in the rural market overtook urban markets this year - a 17-18% growth in the urban market, against over 20% growth the rural market. About 35% of the demand for FMCG products comes from rural areas as the affluent segment in villages grew at a faster rate than the urban one.
- Price rises continue to be the first reaction by companies to protect margins. Cost-cutting, a judicious product mix and new launches helped firms ride the downtrend.
- Though subdued, films and other media continue to impact Indian psychographics thus generating continued demand for “lifestyle” products specially favoured brands in clothes, cosmetics, food etc.

Telecom

- Telecom continues to record one of the highest growth rates, despite the financial meltdown. The sector has grown by over 26% over the last five years with a GSM subscriber base of 27.25 cr in Jan 09. The main areas of growth are from rural, semi-urban and Tier 2 & 3 cities. The total mobile user base rose by 48% to 346mn in 2008. The subscriber base has the potential of doubling over the next five years. With a population of 1.2bn, the potential subscriber base is around 800mn whereas actual subscribers amount to 385mn only.
- Telecom development in rural areas assumes special significance in India as more than 70 per cent of the population lives in villages. A well spread out provision of affordable telecom services in rural areas enhances the ability of people to participate in market economy, which in turn improves their productivity and contributes to their earnings.

- Issuance of fresh cellular licenses has fuelled competition leading to investment in telecom infrastructure as the operators compete for growing mobile telephony market.
- While India waits for 3G, telecom companies are finalising their spectrum auction strategies and plans to roll out 3G services in the country. 3G will help resolve the issue of urban plateau, spectrum availability for 2G and mobile broadband penetration that will further boost adoption of value added services.
- Internet services across mobile phones provide the next step in internet growth in India. Mobile web usage and traditional web are almost equal in India (2.4 days per week mobile versus 2.7 days traditional) as more users are finding out about new product information via the mobile web (28%) than the traditional web (26%).

Consumer Durables

- Consumer durables recorded a 7.3% growth in the first three quarters of 2008-09 and were primarily responsible for the growth of the consumer goods sector.
- Demand for essential household appliances, driving the consumer durables market, continues to remain stable. Main contributors to demand include rural, semi-urban and non-metro cities that are insulated from the impact of the global recession.
- Penetration of emerging markets provides this sector with great opportunity to grow, especially as producers pass on the benefits of the government stimuli to consumers in the form of lower prices.
- Demand in consumer durables will rise as the economy stabilises and delayed purchases of durables are resumed by households.

Opening new doors of opportunity for you...

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