STRONG MACRO-ECONOMIC FUNDAMENTALS AND REFORMS FOR SUSTAINED GROWTH

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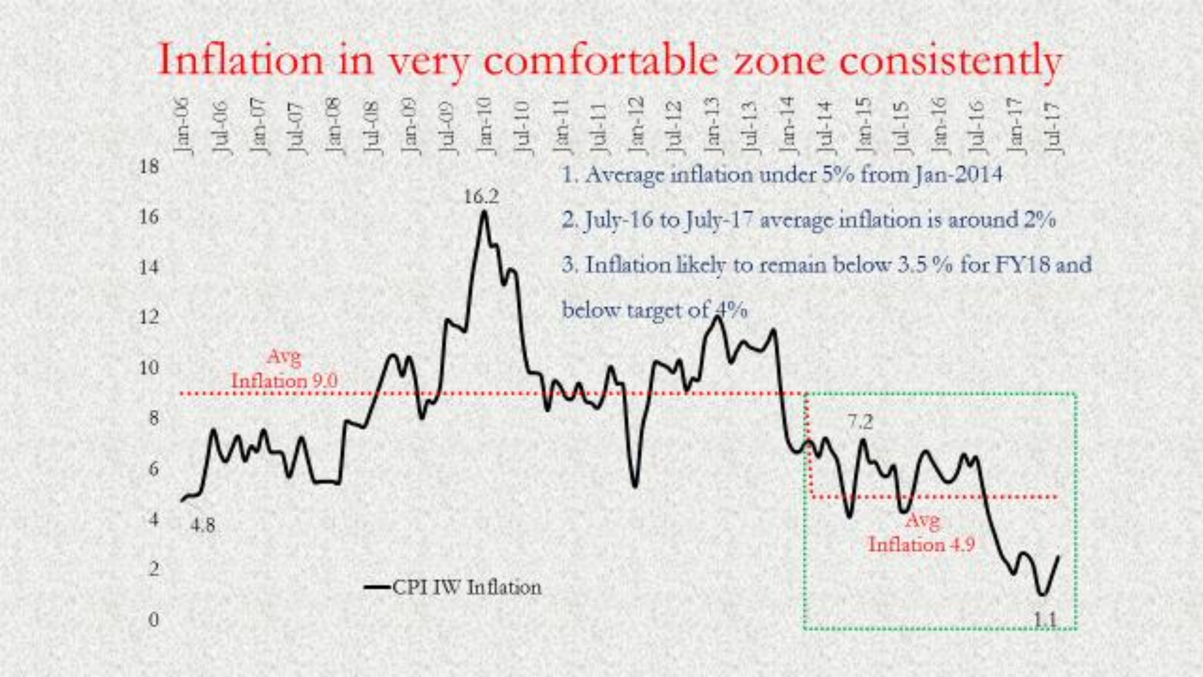
I. INDIA A HAVEN OF MACROECONOMIC STABILITY

Strong economic growth

- India grew at a very strong pace of 7.5% p.a. in the three years of 2014-17 with growth exceeding 8% in 2015-16. There was a temporary slippage in growth in the last two quarters thanks to transitional effect of Demonetisation and GST. That effect is now over, with all indicators – IIP, Core Sector, Index, automobile, consumer spending etc. pointing out a strong growth pick up, there is expectation of very good growth from second quarter of current year itself.
- The current global economic outlook is marked by relatively stronger activity in both advanced economies and emerging market & developing economies. Global economic activity is on the course of gradual improvement and the world GDP is projected to grow at the rate of 3.6 per cent and 3.7 per cent in 2017 and 2018 respectively, after remaining subdued in 2016, when it was 3.2 per cent. Significant improvement in investment, trade, and industrial production, coupled with strengthening business and consumer confidence, are supporting the recovery. This would also help in growth of exports which is reflected in strong export growth of 25.6% in September 2017 with April-September growth averaging nearly 12%.

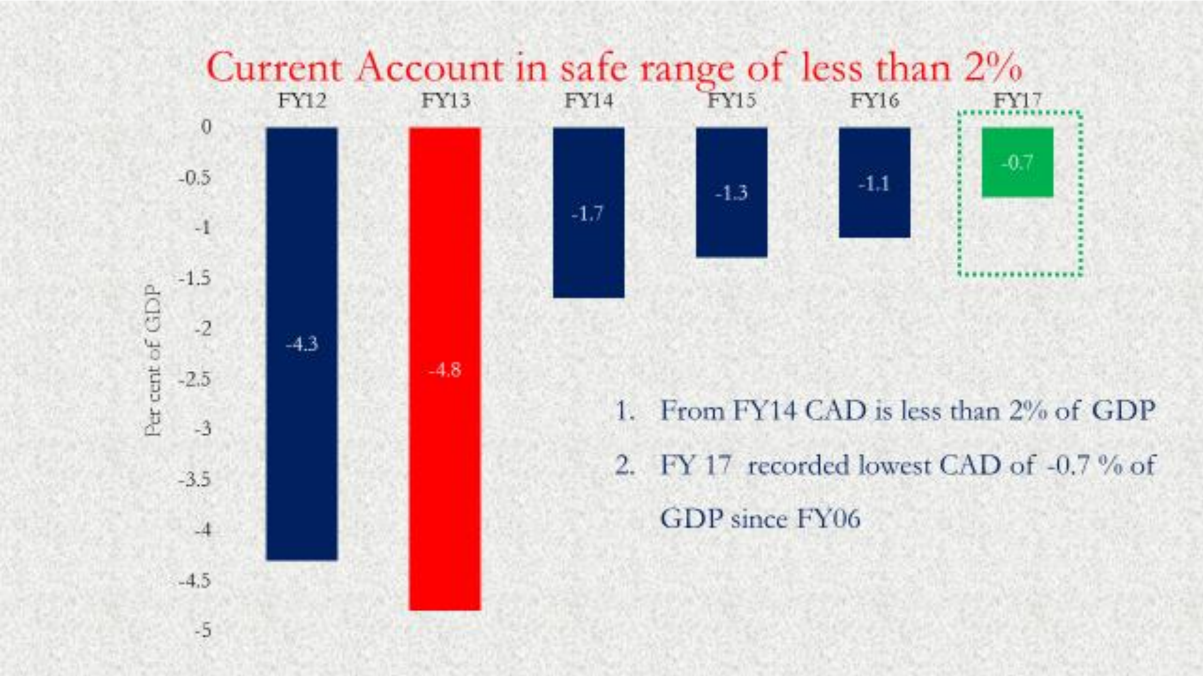
Inflation has been brought under control

- The decisive steps taken by the Government along with decline in crude prices from its high levels in 2013-14 and benign global prices of tradables helped the economy to get out from inflationary spiral to relatively stable prices. Inflation declined from nearly double digits in 2012-13 and 2013-14 to an average of less than 5 per cent since then. Between July 2016 and July 2017, the inflation rate was close to 2 per cent. Inflation based on CPI is currently within the target of 4 per cent and is expected to be close to 3.5 per cent for the financial year 2017-18. Inflation is currently well within the target of 4 per cent. However, the RBI has projecting it to increase to 4.2-4.6 per cent in the second half of the current financial year, a little higher than 4 per cent target, but within the range of 4+/-2 per cent.
- Headline inflation based on Consumer Price Index (Combined) averaged 4.9 per cent in 2015-16 as compared to 5.9 per cent in 2014-15. CPI inflation for 2016-17 averaged 4.5 per cent. The year-on-year inflation in April-September 2017 was 2.6 per cent as compared to 5.4 per cent in the corresponding period of the previous year.



External sector indicators have improved significantly despite global sluggishness

- Along with lower inflation, lower level of current account deficit has brought about much of macro-economic stability in the last 3-4 years. Current account deficit was at dangerously high level of over 4 per cent in 2011-12 and 2012-13, leading to a significant instability in the exchange rate of the rupee. With significant improvement in the current account balance as reflected by lower levels of current account deficit, the volatility in the exchange rate also declined considerably.



- World trade volume (goods and services) growth continued to decelerate in 2016 to 2.2 per cent from 2.8 per cent in 2015 (IMF's WEO, October 2017). It is projected to pick up with growth of 4.2 per cent in 2017 and 4.0 per cent in 2018.

India's Merchandise trade

- Exports declined in 2015-16 primarily on account of the sluggish global demand and imports declined due to steep decline in international crude oil prices as well as the decline in the prices of other commodities. During 2016-17, exports grew by 5.2 per cent while imports increased by 0.9 per cent, helping in narrowing the trade deficit. Merchandise exports and imports grew by 11.5 per cent and 25.1 per cent respectively in dollar terms during April-September 2017, resulting in widening of trade deficit from US$ 43.4 billion in April-September 2016 to US$ 73.1 billion in April-September 2017.
- The current account deficit (CAD) for 2015-16 was 1.1 per cent of GDP as compared to 1.3 per cent of GDP in 2014-15. The CAD further narrowed to 0.7 per cent of GDP in 2016-17 on the back of the contraction in the trade deficit that narrowed to US$ 112.4 billion in 2016-17 from US$ 130.1 billion in 2015-16. However, current account deficit widened to US$ 14.3 billion (2.4 per cent of GDP) during Q1 2017-18 from US$ 0.4 billion (0.1 per cent of GDP) during Q1 2016-17, mainly on account of higher trade deficit in this period.

Robust foreign direct investment

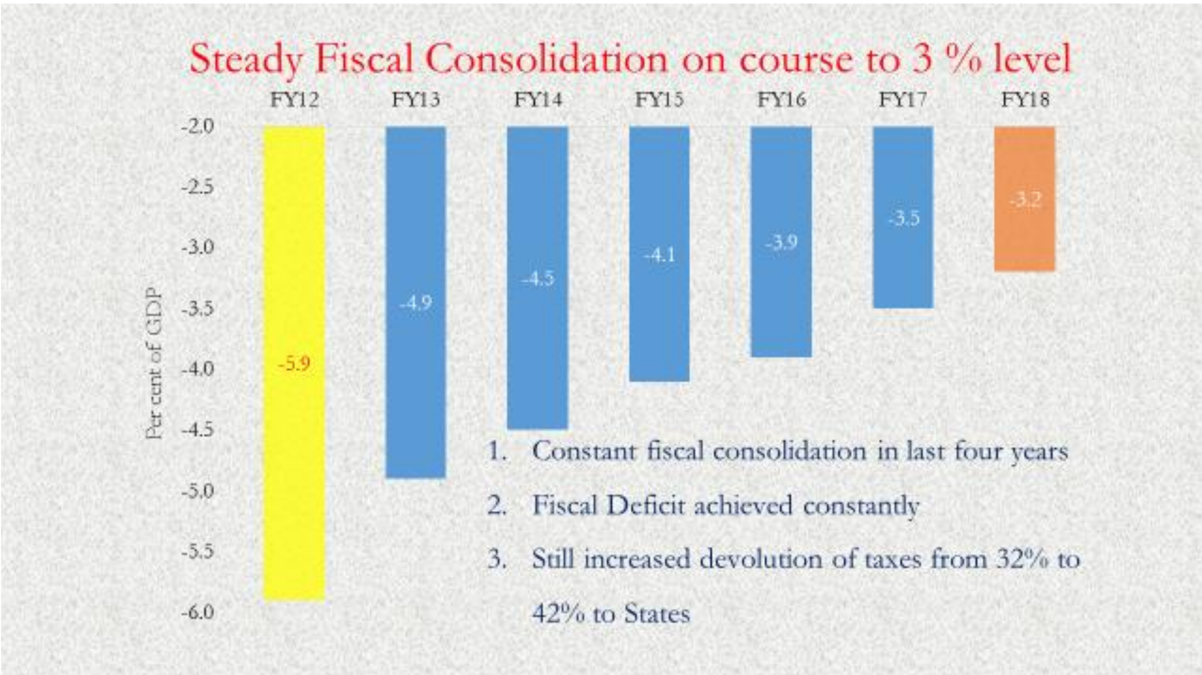
The gross FDI flows to India in 2016-17 amounted to US$ 60.2 billion, as compared to US$ 55.6 billion in 2015-16 and US$ 45.1 billion in 2014-15, indicating the improved global confidence on the Indian economy. During April-August 2017, the gross FDI inflow in the economy was US$ 30.4 billion, higher as compared to the inflow of US$ 23.3 billion in the corresponding period of the previous year.

Foreign exchange reserves

Foreign exchange reserves stood at US$ 370 billion at the end of March 2017 as compared to 360.2 billion as at end March, 2016. As on 13th October 2017 the foreign exchange reserves exceeded US$ 400 billion. With increase in reserves in the last couple of years, most reserve-based external sector vulnerability indicators have improved.

Steady improvement in fiscal situation and fiscal consolidation is on track

There has been a steady consolidation of fiscal deficit in the last few years. Fiscal deficit of the central government had reached alarmingly high level of close to 6 per cent 2011-12 and averaged over 5 per cent between 2011-12 and 2013-14. The government is committed to fiscal consolidation path and has shown a steely resolve to reduce the fiscal deficit to 3.5 per cent of GDP in 2016-17 and further to 3.2 per cent as per the Budget estimates in 2017-18.



Fiscal deficit of the Government of India as a ratio of GDP was 3.9 per cent in 2015-16 and 3.5 per cent for 2016-17 [Revised Estimate] and is budgeted to be 3.2 per cent in 2017-18. Focus on expenditure rationalization with plugging loopholes in public expenditure and innovative revenue raising efforts have helped to achieve this.

From the angle of internal and external public debt stock, India does not face serious fiscal solvency related issues. Government of India's total outstanding liabilities-to-GDP ratio is budgeted to decline from 46.7 per cent by year-end 2016-17(RE) to 44.7 per cent by year-end 2017-18.

Tax revenue (net to Centre) is increased by 16.8 per cent in 2016-17 (Provisional Actual) and it is budgeted to grow by 11.3 per cent in 2017-18.

Fiscal deficit during April-August is 96 per cent of the full-year budgeted fiscal deficit on account of front loading of expenditure, but we are reasonably confident that full year budgeted ratio of fiscal deficit of 3.2 per cent of GDP will not be breached.

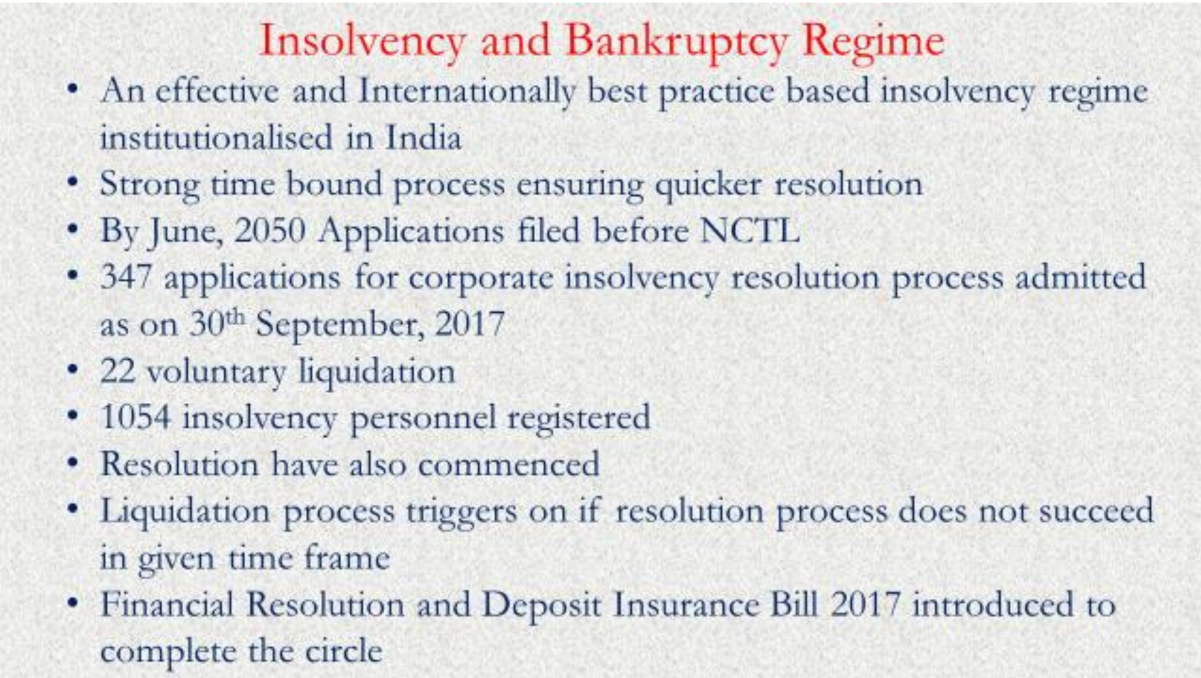
II. TRANSFORMATIONAL REFORMS

Landmark Reform in the form of GST

Subsuming a large number of Central and state indirect taxes, the GST has been a landmark reform that has been implemented with effect from 1st July 2017. The launch of the GST represents an historic economic and political achievement, unprecedented in Indian tax and economic reforms, which has rekindled optimism on structural reforms. This has resulted in unified tax across the country and has helped in removing transport restrictions on the movement of goods resulting in their faster movement and help in creating common market, reduction in corruption and leakage and further help in Make in India programme. It is expected to provide boost to revenues, investment, and medium-term economic growth. Despite the teething troubles that the government and the GST Council are addressing, initial results in the form of revenue raised seem encouraging.

Insolvency and Bankruptcy Code

Another game changing reform has been The Insolvency and Bankruptcy Code, 2016 (Code) that was enacted on May 28, 2016, with an aim to consolidate the laws relating to insolvency of companies and limited liability entities (including limited liability partnerships and other entities with limited liability), unlimited liability partnerships and individuals, presently contained in a number of legislations, into a single legislation. The Code provides a comprehensive, modern and robust insolvency and bankruptcy regime, at par with global standards and even better in some aspects.



The Government moved at a quick pace to implement the Code. About 2050 applications have been filed before NCLT so far, of which, 112 applications have been admitted and another 146 have been rejected or withdrawn. The default underlying admitted applications range from a few lakh of rupees to a few thousands of crores. The announcement of 12 large defaulters by the RBI will expand this sharply.

Crusade against Black Money including demonetization

The initiatives like: (a) Special Investigation Team on Black Money, constituted in May, 2014 for monitoring investigations and reviewing the framework for curbing black money; (b) Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015, enacted w.e.f. 1st July 2015; (c) the Income Declaration Scheme, 2016; and (d) enactment of the comprehensive Benami Transactions (Prohibition) Amendment Act, 2016, w.e.f. 1st November, 2016 had made varying degrees of success in the fight against black money generation and holding. The follow-up to these measures in terms of demonetization of the high denomination notes w.e.f. the expiry of 8th November, 2016 effected a body blow on black money.

Housing Development

Government has announced various measures in the Budget 2017-18 to promote growth of the economy which, *inter alia*, include push to infrastructure development by giving infrastructure status to affordable housing, higher allocation to highway construction, focus on coastal connectivity. The other growth promotion measures include: lower income tax for companies with annual turnover up to Rs 50 crore; allowing carry-forward of MAT credit up to a period of 15 years instead of 10 years at present; further measures to improve the ease of doing business; and, major push to digital economy. The Budget also targeted to provide higher agricultural credit and to increase employment significantly.

Institutional reforms

Institutional reforms including expenditure rationalization and progressive elimination of leakages in public delivery through stress on targeting and direct benefit transfer; instituting a profoundly impactful financial inclusion programme; measures to improve policy transparency in governance and decision-making; Ujwal DISCOM Assurance Yojana (UDAY) programme for DISCOMs; liberalization of FDI norms in various sectors; and approval of National Intellectual Property Rights Policy for laying down the future roadmap for intellectual property in India.

Improved ease of doing business

The complementarities built around the flagship Make-in-India programme, including comprehensive measures for improving the ease of doing business, encouragement to budding entrepreneurial talent under the Start-up India and Stand-up India Initiatives and advertisement and global campaign, have evidently improved India's global ranking as a business destination. India has launched eBiz platform for creating a business and investor friendly ecosystem by making all business and investment related clearances and compliances available on a 24x7 single portal, with an integrated payment gateway.

Radical changes in FDI policy regime; most sectors on automatic route for FDI

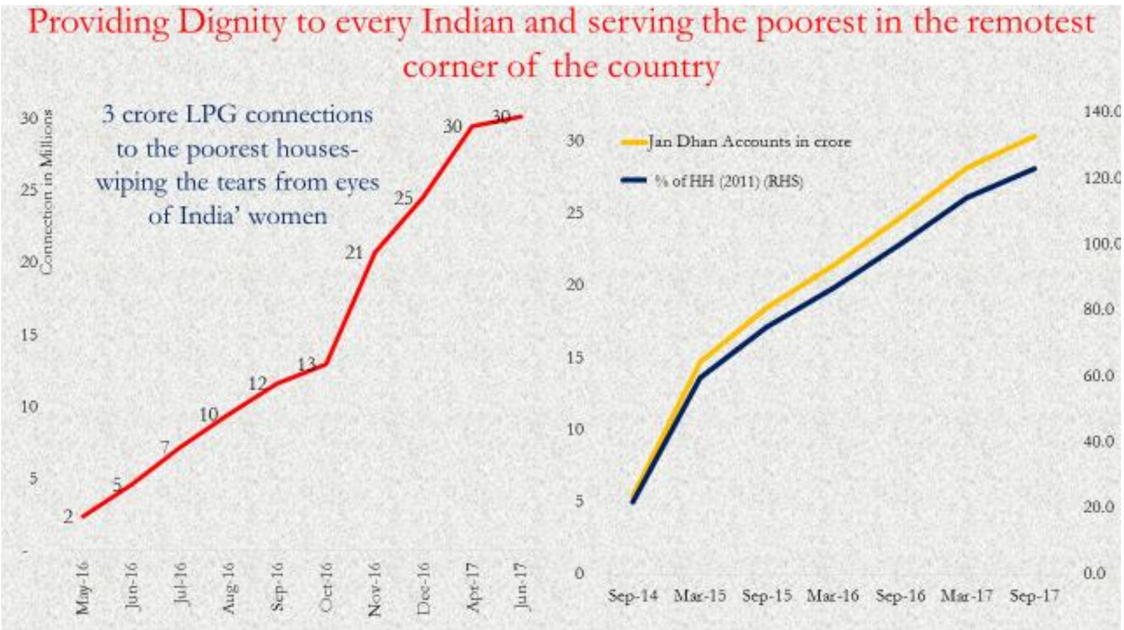
The Government radically liberalized the FDI regime on 20thJune 2016, with the objective of providing major impetus to employment and job creation. This is the second major reform after the major changes announced in November 2015. Now most of the sectors would be under automatic approval route, except a small negative list. Changes introduced in the policy include increase in sectoral caps, bringing more activities under automatic route and easing of conditionalities for foreign investment. With these changes, India is now one of the most open economies in the world for FDI.

Ambitious Disinvenstment Programme

Progressively higher revenues have been raised from disinvestment in public sector undertakings in the last three years and the government has a very ambitious target of raising much higher revenues in the current financial year.

Reaching Welfare Programme for poorest families in North-East Corners

In order to help the poorest of the poor, and to improve their living conditions, particularly that of women, the government has provided over 3 crore LPG connections between May 2016 and June 2017 which will replace the dirtier traditional fuels that are health hazard. Similarly in order to secure poor people from shocks of man-made and natural disasters, total enrolment under Pradhan Mantri Jeewan Jyoti Bima Yojana and Pradhan Mantri Swasthya Bima Yojana was14 crore persons by September 2017.



III. INFRASTRUCTURE PUSH

Government has consistently increased Public Expenditure on Infrastructure in order to boost employment and provide renewed impetus to economic growth. Government of India's total expenditure this year has crossed Rs 11.47 lakhs crores (upto Sept '17), out of the budgeted expenditure Rs 21.46 lakhs cr. (an increase of Rs. 1.2 lakhs cr. over last year).

Special thrust of this drive is on key development sectors including Rural Roads, Housing, Railways, Power, Highways and Digital Infrastructure. The Capex target of Government of India for 2017-18 is Rs. 3.09 lakhs crores, which is 31.28% higher than last year, out of which Rs. 1.46 lakhs crores has been spent on capital works till September 2017. In addition, Government of India had fixed a Capital expenditure target for CPSEs for 2017-18 at Rs 3.85 lakhs crores, out which capex spending of Rs 1.37 lakhs crores has been achieved by CPSEs till Sept'17.

Railways

- A target of Rs.1,31,000 crore has been made for Capital Expenditure for the Railways. *Against the target, an expenditure of Rs.50,762 crore has been achieved.* The main thrust is on upgrading the infrastructure to improve safety, laying of new lines and providing passenger amenities.
- The following are the key among the capital works completed : New Lines (Construction) (Rs.4531.93 cr), Gauge Conversion (Rs.1842.24 cr), EBR-Partnerships (Rs.11504.29 cr), Track Doubling (Rs.4069.60 cr), Traffic Facilities (Rs.517.05 cr), Rolling Stock (Rs.8214.11 cr), Leased Assets-Principal Component (Rs.7781.97 cr), Road Over/Under Bridges (Rs.1068.09 cr), Track Renewals (Rs.2837.72 cr), Electrification Projects (Rs.1119.17 cr), Passenger Amenities (Rs.539.73 cr), Investment in JV/SPVs (Rs.1263.52 cr), Metropolitan Transport Projects (Rs.446.16 cr), etc.

Saubhagya (Pradhan Mantri Sahaj Bijli Har Ghar Yojana)

- Under this program, Universal Electrification is being taken up to provide last mile connectivity and electricity connections to all remaining un-electrified households in the country by Mar '19. This is an addition to the ongoing Scheme of Rural Electrification (Deen Dayal Upadhay Gram Jyoti Yojana).
- Outlay proposed is Rs.16,320 crores, involving GoI support of Rs.12319.50 crores

Rural roads – PM Gram Sadak Yojana (PMGSY)

- In order to complete Phase-I and II of PMGSY, Government of India, along with States, proposes to spend Rs. 88,185 crores over 3 years starting 2017-18.

This will result in construction of 1,09,302 km of rural roads covering 36,434 habitations.

- In addition, roads worth Rs 11,725 crores, involving 5411 km of upgradation of existing roads and construction of new roads in 44 LWE districts, will be completed by 2019-20.

PM Awas Yojana (PMAY) – Urban & Gramin

- Universal Affordable Housing for All is being implemented and accelerated to give a big boost to the construction sector. Under PMAY (Urban), 1.2 crore units will be built with an outlay of 1,85,069 crores over next 3 years. Under PMAY (Gramin), 1.02 crore units will be built (51 lakhs units this year) with an outlay of Rs. 126,795 crores by Centre and States by March '19.

Bharatmala Pariyojana

- Taking forward it's commitment to providing more efficient transportation, Government has debottlenecked the Roads sector and significantly stepped up the Highway development and road building program. In order to further optimise the efficiency of movement of goods and people across the country, Government is launching a new Umbrella program. This Road Building Program, for 83,677 km of roads involving capex of Rs.6.92 lakhs crores over next 5 years.
- Out of this, Bharatmala Pariyojana to be implemented with an outlay of Rs.5,35,000 crores will generate 14.2 crores mandays of jobs.
- The following categories of roads (34,800 km) have been proposed under BMP
    - Economic Corridors (9000 km)
    - Inter Corridor and Feeder Route (6000 km)
    - National Corridors Efficiency Improvement (5000 km)
    - Border Roads and International Connectivity (2000 km)
    - Coastal Roads and Port Connectivity (2000 km)
    - Green field Expressways (800 km)
    - Balance NHDP works (10,000 km)
- Bharatmala works have been proposed for completion in 5 years by 2021-22 through NHAI, NHIDCL, MoRTH and State PWDs.
- Substantial delegation of powers has been provided to NHAI, NHIDCL and Ministry of Road Transport & Highways to enable speedy implementation.
- *Funding for BMP*: Rs.2.09 lakhs crores will be raised as debt from the market, Rs.1.06 lakhs crores of private investments would be mobilized through PPP and Rs. 2.19 Lakhs crores is to be provided out of accruals to the Central Road Fund (CRF), ToT Monetisation proceeds and Toll collections of NHAI.
- In addition to 34,800 km under Bharatmala, balance works of 48,877 km of works under other current schemes will be implemented in parallel by NHAI/MoRTH with an outlay of Rs.1.57 lakhs crores. This will be financed by

providing Rs. 0.97 lakhs crores from CRF and Rs. 0.59 lakhs crores as Gross Budgetary support.

- *ToT Monetisation*: For the first time ever, monetisation of 82 operating highways under a low risk Toll – Operate- Maintain-Transfer (ToT) Model has been initiated with a private investment potential of Rs 34,000 cr. The 1st bundle of 9 NH stretches of 680.64 Km has been put out to tender by NHAI with potential monetization value of Rs. 6258 cr.

Given the strong macroeconomic fundamentals of the economy and the continued public spending at substantially enhanced levels in comparison to previous years, Government has taken several steps to improve the investment climate in the country. The comprehensive economic reforms undertaken by the government have resulted in unprecedented levels of foreign direct investment in the last 3 years. However, the domestic investment of the private sector continued to be affected by the growing contamination of loans advanced in the past, which have now become unsustainable. Besides affecting the general investment climate these non-performing loans have also necessitated an unprecedented levels of provisioning, particularly in the public sector Banks. This in turn has affected their lending capabilities that has particularly affected the Medium and the Small scale sector. It may be seen that while many corporates have accessed the bond market in the recent past, it is the MSMEs that have been deprived of capital due to the inability of the Banks that are weighed down by the excessive burden of very demanding provisioning norms. This called for effective steps for creating a conducive environment in which PSBs could provide loans to the private sector, especially the Medium & Small Scale industries.

IV. RECAPITALIZATION OF PUBLIC SECTOR BANKS

- **Government Commits to Unprecedented Strengthening of Public Sector Banks**
- **Rs. 2,11,000 Crore Front-loaded Bank Recapitalisation to Clean Up Legacy of NPAs**
- **Credit Growth to Take-off through Recapitalised Banks**
- **Banks to Give Big Push to MSMEs for Jobs and Growth**

Government has decided to take a massive step to capitalise PSBs in a front-loaded manner, with a view to support credit growth and job creation. This entails mobilization of capital, with maximum allocation in the current year, to the tune of about Rs. 2,11,000 crore over the next two years, through budgetary provisions of Rs. 18,139 crore, recapitalisation bonds to the tune of Rs. 1,35,000 crore, and the balance through raising of capital by banks from the market while diluting government equity (estimated potential Rs. 58,000 crore).

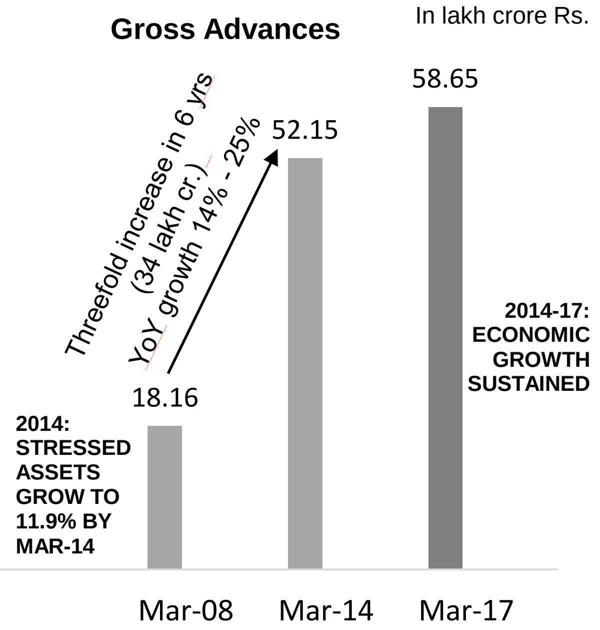
Government actions are not limited to addressing capitalisation of PSBs. Definite steps will be taken alongside capitalisation to enable them to play a major role in the financial system. PSBs having 70% market share in the banking space will be geared for greater growth and to contribute through enhanced credit off-take. The stage has been set with a 'MUDRA Protsahan' campaign across the country.

There will be a strong push on enabling growth of MSMEs through enhanced access to financing and markets, and a drive to finance MSMEs in 50 clusters. While Ministries concerned will spearhead and provide momentum, banks will undertake speedy processing of loan applications in a hassle-free manner. Fintech companies will be roped in to cut down the appraisal process and generate quality loan applications. MSMEs will be handheld by extending support through:

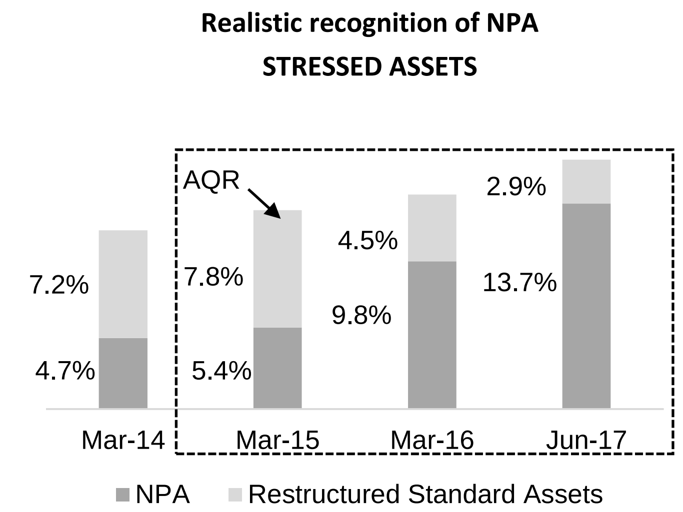
- ✓ Compulsory TReDS (Trade Receivables electronic Discount System) registration by major PSUs within next 90 days, for shortening the cash cycle
- ✓ Sector-specific Mudra financial products, such as Mudra Leather, Mudra Textiles, etc.
- ✓ 100 bank-approved MSME project templates for speedier credit
- ✓ Revamped *udyamimitra.in* portal, so that banks compete for financing MSME projects
- ✓ Drive for registering MSMEs on the GeM (Government electronic Marketplace) portal and e-commerce platforms

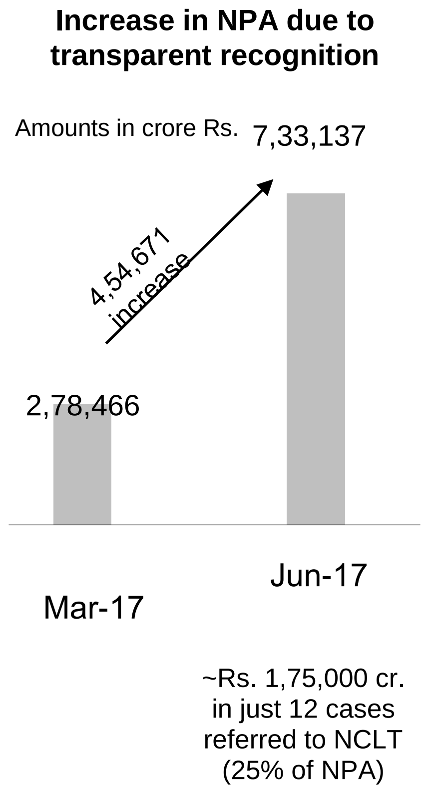
It may be recalled that aggressive loaning to sectors with excess capacity and poor due diligence created large stressed assets, which grew to 11.9% by March 2014.

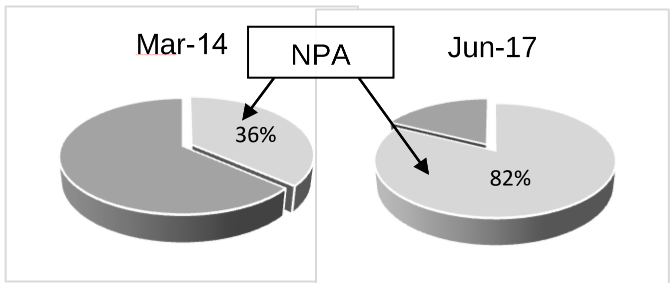
Asset Quality Review (AQR) carried out in 2015 for clean and fully provisioned bank balance-sheets revealed high incidence of NPAs. Expected losses on stressed loans, not provided for earlier under flexibility given to restructured loans, were reclassified as NPAs and provided for. PSBs initiated cleaning up by recognising NPAs and provided for expected losses.



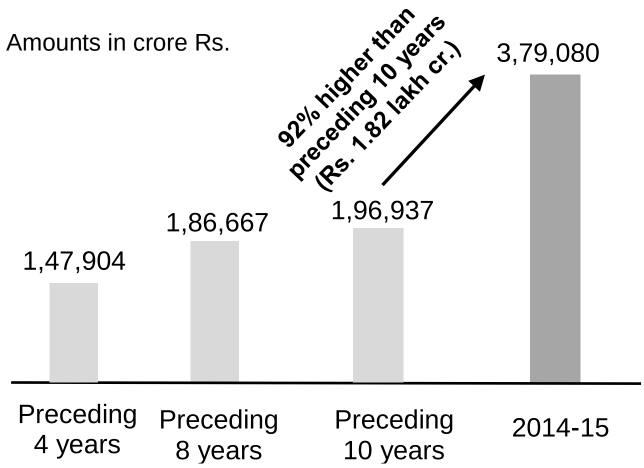
Gross NPAs in PSBs rose rapidly from 2015, from 5.43% (Rs. 2,78,466 crore) in March 2015 to 13.69% (Rs. 7,33,137 crore) as of June 2017. Provisioning for expected losses grew substantially. From 2014-15 to 2017-18 Q1, Rs. 3,79,080 crore provisioning was made, whereas during the preceding ten years total provisioning was Rs. 1,96,937 crore only. This was the right approach to dealing with expected losses on account of stressed loans.







Government recapitalised and initiated other reforms alongside the cleaning-up exercise, to make PSBs transparent and more efficient. Bank Board Bureau was set up, and steps were taken to appoint non-Executive Chairmen in PSBs.



Indradhanush Plan for recapitalising and revamping PSBs was announced by the Government on 14.8.2015. Government envisaged capital need of Rs. 1,80,000 crore till 2018-19. Accordingly, Government made provision of Rs. 70,000 crore and projected market-raising of capital by banks to the tune of Rs. 1,10,000 crore. So far, Government has infused capital of Rs. 51,858 crore in PSBs. PSBs, under stress due to AQR and NPA recognition, have so far been able to raise Rs. 21,261 crore from the market. The launch of Indradhanush before the sharing of AQR findings by RBI with PSBs in December 2015 enabled PSBs to successfully remain Basel III compliant despite high NPA and consequential provisioning requirement identified through AQR. The present decision further builds upon Indradhanush.

Government also undertook several legislative changes to facilitate recovery and resolution of stressed assets. The Insolvency and Bankruptcy Code, 2016 was enacted as a unified framework for resolving insolvency and bankruptcy matters. The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act) and the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (which governs Debt Recovery Tribunals) were amended in 2016 to facilitate faster recovery. Further, the Banking Regulation Act, 1949 was amended this year to enable Government to authorize RBI to direct banks to initiate the insolvency resolution process under the Insolvency and Bankruptcy Code.

These bold steps taken over the last three years not only addressed legacy issues but gave a strong impetus to reforms aimed at rebuilding the strength of PSBs. The process of building stronger, bigger banks has begun with the consolidation of State Bank of India and the announced recapitalisation will give it greater impetus. A differentiated approach will be followed for this, based on the strengths of each PSB.

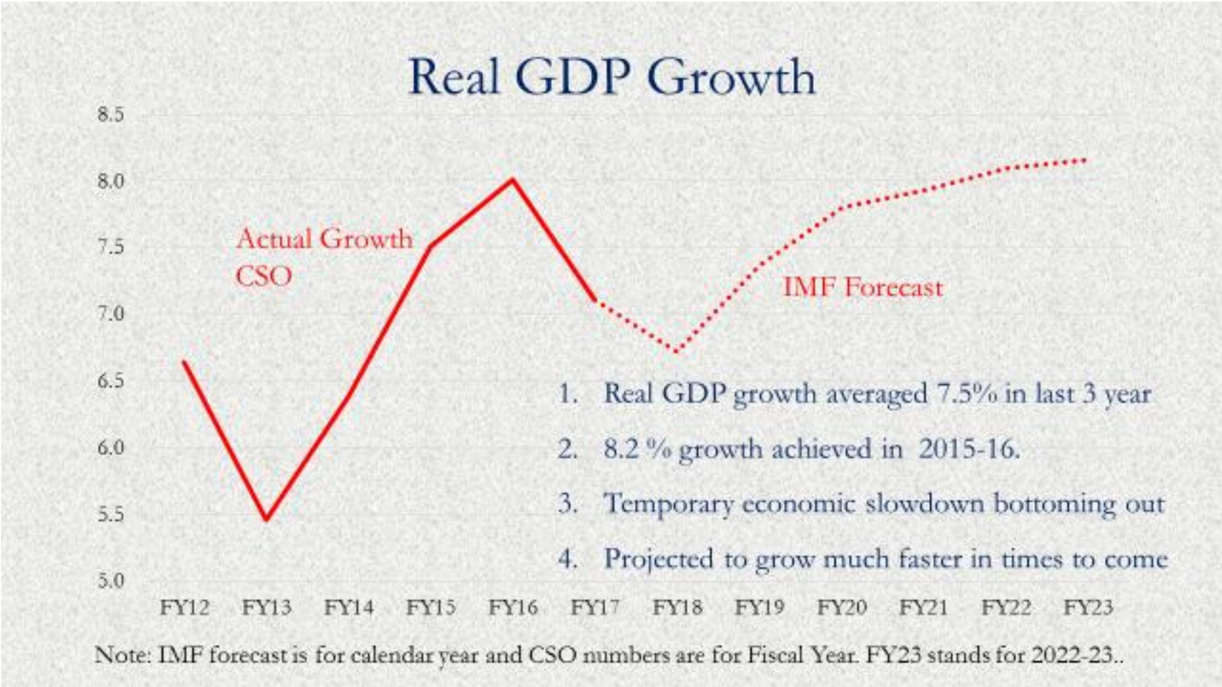
The unprecedented recapitalisation and the initiatives announced today are expected to have a noticeable impact in the near-term, contributing to accelerated economic activity, employment and growth of the economy.

V. STRONGER ECONOMIC GROWTH AHEAD

The real growth of the economy as measured by the GDP growth showed a steady improvement when it averaged 7.5 per cent between 2014-15 and 2016-17 vis-à-vis 5.9 per cent in the previous two years. Although there has been some reduction in the growth in the last few quarters, one expects it to be a temporary blip and going by the available indicators the downslide seems to have bottomed out and can expect the GDP growth to start rising again.

As per the 4thAdvance Estimates of production of food-grains released by Department of Agriculture, Cooperation and Farmers Welfare for 2016-17, the production of total food-grains is expected to be 275.7 million tonnes, 9.6 per cent higher as compared to last year's total food-grains production of 251.6 million tonnes. As per the 1st Advance Estimates for 2017-18, the foodgrains output for Kharif season is likely to be 134.67 million tonnes as against 138.52 million tonnes as per the 4thAdvance Estimates of 2016-17.

Despite subdued global economic condition and resulting lower levels of demand for India's exports demand, the Index of Industrial Production (IIP) grew by 4.6 per cent during 2016-17 as compared to a growth of 3.3 per cent in 2015-16 (as per the revised IIP series. During April-August 2017 the general IIP growth was 2.2 per cent as compared to a growth of 5.9 per cent in the same period of previous year. During August 2017, the IIP registered a growth of 4.3 per cent, significantly higher than the growth of (-) 0.2 per cent in June and 0.9 per cent in July 2017. The sales of passenger vehicles registered a growth of 11.3 per cent for September 2017 and 9.2 per cent for April-September. Similarly, the sales of commercial vehicles increased by 25.3 per cent in September 2017 and 6 per cent for April-September 2017.



As per IMF's assessment in October 2017, India's growth is expected to be at 6.7 per cent in 2017 and 7.4 per cent in 2018. IMF has also projected that India's growth would increase to 8.2 per cent by 2022. China's growth in 2016 was 6.7 per cent and is expected to be at 6.8 per cent and 6.5 per cent in 2017 and 2018 respectively. We expect strong growth rebound in the quarters and years ahead – may be better than even IMF's projections.