Country Report

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The Economist Intelligence Unit

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India

Forecast

Highlights

Outlook for 2016-20

Data and charts

Summary

Recent analysis

Politics

Economy

Highlights

Editor: **Firat Unlu**

Forecast Closing Date: **July 1, 2016**

Outlook for 2016-20

- The Economist Intelligence Unit expects the National Democratic Alliance (NDA) coalition, led by the Bharatiya Janata Party (BJP), to remain in power in 2016-19, providing political stability while pursuing pro-business policies.
- The government will pass incremental economic reforms. However, lacking a majority in the upper house of parliament, important aspects of its policy agenda, such as labour and land reforms, are unlikely to be implemented.
- State elections will be held throughout 2016-20, determining the composition of the upper house. However, these are not expected to change the balance of power in the chamber unless more parties join the centre-right NDA.
- A narrow tax base, high expenditure on infrastructure and social-welfare payments will strain the public finances. The budget deficit will average the equivalent of 3.7% of GDP in fiscal years 2016/17-2020/21 (April-March).
- We expect the Reserve Bank of India (RBI, the central bank) to maintain its accommodative monetary policy stance until mid-2017. It will then raise policy interest rates at a gradual pace until 2019 to meet its inflation target.
- Real GDP growth will average 7.4% a year in 2016/17-2020/21. Growth would be even faster but for ongoing infrastructure bottlenecks, some shortages of skilled labour, and legal and regulatory barriers.

Review

- The government announced that it would liberalise the foreign direct investment regime in a number of sectors, including defence, pharmaceuticals, civil aviation and single-brand retailing.
- According to the Ministry of Finance, the government met its budget deficit target for 2015/16, which had been set at the equivalent of 3.9% of nominal GDP.
- On June 18th the governor of the RBI, Raghuram Rajan, released a statement saying that he would not seek another term at the central bank. He will return to academia when his term ends on September 4th.
- Following its bimonthly meeting on June 7th, the RBI kept its main policy interest rate, the repurchase (repo) rate, unchanged at 6.5%. The reverse repo rate was also left on hold, at 6%.
- According to data released by the Ministry of Commerce and Industry, merchandise exports fell marginally in May, by 0.8% year on year to US$22.2bn. Imports of goods contracted by a stronger 3.7% to US$28.4bn.
- The current-account deficit stood at US$318m in the first quarter of 2016, or the equivalent of 0.1% of nominal GDP, according to RBI data.

Outlook for 2016-20

Political stability

The Economist Intelligence Unit expects the National Democratic Alliance (NDA) coalition to remain in power in 2016-19, maintaining political stability at national level. The NDA is led by the centre-right Bharatiya Janata Party (BJP)—the party of the prime minister, Narendra Modi—and holds a majority of seats in the Lok Sabha (the lower house of parliament). The BJP won a decisive victory at the 2014 parliamentary elections on a platform of improving the economy by pursuing reforms, combating corruption, lowering inflation and upgrading infrastructure. These campaign pledges will set the backdrop for its legislative agenda in 2016-19.

However, many of the government's proposed reforms need to be passed by both the lower chamber and the Rajya Sabha (the upper house), where states are represented. As the government lacks a majority in the upper house and faces a hostile opposition, its ability to implement its ambitious reform agenda will be constrained. Consequently, the administration will shift its focus to enhancing the efficiency of India's bureaucracy and areas where the upper house's ability to interfere is relatively limited. This will include expanding road and rail networks and boosting power supply.

Despite the poor outlook for productive political engagement between the governing coalition and opposition parties, parliament will not suffer from complete gridlock. This was seen in May, when parliament passed the Finance Bill and the Insolvency and Bankruptcy Code 2016. Support from regional parties will also bolster the government's chances of passing legislation in the Rajya Sabha on an issue-by-issue basis (including the controversial goods and services tax). However, this will be complicated by the efforts of the main opposition Indian National Congress party to block key elements of the government's legislative agenda. Congress will soften its opposition at times, concerned that repeated instances of obstructionism and parliamentary disruption may result in loss of support from reform-minded voters.

Sectarian and communal tensions will pose a threat to political stability during the forecast period. Mr Modi seems to have little control over the BJP's extreme right-wing affiliates, whose actions have the potential to damage India’s secular social fabric. Some groups, such as the Rashtriya Swayamsevak Sangh, have backed calls to recast India as a Hindu nation. The BJP will need to be careful to avoid antagonising its right-wing supporters, as they form an important part of its electoral base. However, the BJP also faces strong public pressure to safeguard India's long-standing values of diversity, tolerance and plurality. These two opposing pressures threaten to undermine the party's appeal to voters and embolden the opposition in its obstructionist stance on reforms.

Mounting social pressures have led to violent protests—occasionally affecting business continuity—by various social groups and castes. Despite robust economic growth, competition for meaningful job opportunities will be fierce over the forecast period. Consequently, further protests by castes and other social groups demanding assistance from the government will pose risks to political stability, particularly as rival parties may jockey for electoral support in return for promises of patronage.

The government must also contend with insurgencies in the volatile north-east and with militant communist groups in eastern states, but we expect the security forces to maintain basic law and order throughout the forecast period. Islamist attacks have moved beyond Indian-administered Kashmir in recent years and there is concern that India will become the target of attacks sponsored by Islamic State, an extreme jihadi group operating mostly in Syria and Iraq, in 2016-20.

Election watch

State elections will continue to be held throughout the forecast period, but their impact on the composition of the upper house will be delayed. The BJP will attempt to increase its influence beyond its Hindi-speaking heartland at state polls. We expect it to have partial success in doing so. Meanwhile, Congress will struggle to maintain influence at national level as its grip over state assemblies weakens.

Ironically, this trend may hurt the BJP's chances of securing another majority at the next parliamentary elections in 2019. A weakened Congress would have a strong incentive to build an alliance with other opposition parties. Given India's first-past-the-post electoral system, a united opposition force would have a good chance of unseating the BJP in 2019. However, at present we believe that such an alliance is a distant prospect, owing to the political difficulties involved in bringing together major opposition parties.

International relations

Foreign policy will be shaped by the government's desire to integrate India into global supply chains and attract foreign direct investment (FDI). Consequently, the administration's foreign policy agenda will focus on bringing the country closer to the US, Japan and other nations regarded as an important source of investment or a key destination for India's exports. However, only some of the hoped-for investments will materialise, owing to the relatively difficult local business environment.

To enhance its status as a global power, India will also work to develop trade and transport links with regional neighbours such as Iran. In addition, Mr Modi will seek to maintain India's influence in Nepal and Sri Lanka. However, this will be complicated by a competition over influence with China. This will remain a key obstacle to improved Sino-Indian ties in 2016-20.

The unresolved dispute over Kashmir (which both India and Pakistan administer in part but claim in full) will remain a central issue in Indo-Pakistani relations in 2016-20. Our central forecast is that ties will remain broadly unchanged, with no outbreak of hostilities but no significant improvement either.

Policy trends

The government has voiced its intent to enhance the business environment and realise the country's growth potential by pursuing major supply-side reforms, aimed at boosting the productivity of land, labour and capital. This approach will be accompanied by initiatives in areas such as urbanisation, healthcare, workforce training and digitisation. However, the administration will struggle to implement its reform pledges in full, as it faces strong opposition in the Rajya Sabha and from some civil-society organisations and labour unions. This will make it particularly difficult to pass reform legislation on land and labour reform in 2016-19. There are also concerns that the administration's rhetoric on reform does not match its actual commitment. A lack of progress on measures such as privatisation, which could use up a large amount of political capital, indicates that officials are hesitant to pursue a wide-ranging programme of liberalisation.

The policy emphasis on attracting foreign investment—such as under the "Make in India" initiative, which aims to encourage growth in manufacturing—will not be accompanied by a similar drive to sign more free-trade agreements during the government's term. Without a strategic trade policy, which would expedite liberalisation within India in return for broader and deeper access to foreign markets, the expansion of the country's export-oriented sector will fall well below potential.

In another positive trend, reform momentum will pick up at subnational level. Key states that are responsible for a large share of manufacturing and exports (such as Gujarat, Tamil Nadu and Maharashtra) will implement reforms and ease the regulatory burden.

Fiscal policy

India will continue to record budget deficits over the forecast period as infrastructure spending, financial assistance for those in rural areas and rising demand for a range of public goods, including education and healthcare, will all contribute to higher expenditure. At the same time, the government will make only incremental progress in expanding the tax base. As important state and parliamentary elections (in 2019) approach, public and political pressure for the government to maintain high levels of spending will continue to grow. Consequently, we forecast that the budget deficit will average the equivalent of 3.7% of GDP in fiscal years 2016/17-2020/21 (April-March).

The administration intends to contain the budget deficit to 3.5% of GDP in 2016/17 to demonstrate its commitment to fiscal consolidation. However, its plans will run up against challenging fiscal and political realities, and so we expect it to fall short of that goal. The plans are based on expectations for high income from non-tax revenue sources, such as telecommunications spectrum auctions and state asset sales, which are unlikely to be realised in full. Moreover, in this fiscal year the government may have to increase its bank recapitalisation funds as the proportion of non-performing loans in the financial system expands.

The issue of fiscal decentralisation will become increasingly prominent in 2016–20. This could lead to more efficient public spending as responsibility is devolved to local authorities. As a consequence of greater distribution of fiscal revenue to states, the central government's share of total spending will be reduced. This will reinforce competition between states (often referred to as competitive federalism).

Monetary policy

The RBI will undergo a major institutional shift later this year, when the decision over interest-rate policy will move away from the governor—currently Raghuram Rajan, although he will step down later this year—towards a newly installed monetary policy committee (MPC). The government and the central bank will nominate three representatives each to form the MPC, with the RBI governor having a deciding vote in the event of a tie.

This institutional strengthening will support continuity at the helm of the RBI to some degree. Nevertheless, the likelihood is that Mr Rajan's successor will prove less aggressive in pursuing low consumer price inflation and favour a looser monetary policy stance. In addition, we now expect that the Federal Reserve (the US central bank) will keep its policy rate on hold until 2017 (we had previously forecast two increases in 2016), which will make the RBI more inclined to keep policy accommodative. As a consequence of these changes, we now expect the RBI to cut its main policy rate, the repurchase rate, once again during the remainder of 2016 and then hold rates steady until mid-2017. It will then begin a process of very gradual policy tightening until early 2019 to rein in inflationary pressures and anchor inflation expectations.

The RBI will also remain tasked with monitoring distressed assets in the banking system to help to improve asset quality. However, we expect Mr Rajan's successor to prove less aggressive in addressing non-performing loans. This will reduce some of the pressure on banks and corporates to deal with distressed assets.

International assumptions

	2015	2016	2017	2018	2019	2020
Economic growth (%)						
US GDP	2.4	1.8	2.2	2.3	1.0	2.1
OECD GDP	2.0	1.6	1.6	1.9	1.3	1.7
World GDP	2.4	2.2	2.4	2.6	2.1	2.5
World trade	2.7	2.9	3.6	3.7	2.8	3.3
Inflation indicators (% unless otherwise indicated)						
US CPI	0.1	1.3	2.2	2.3	1.3	1.7
OECD CPI	0.5	0.9	1.8	1.9	1.5	1.8
Manufactures (measured in US$)	-4.6	-1.7	2.6	3.4	4.5	4.3
Oil (Brent; US$/b)	52.4	40.3	52.5	65.0	62.4	61.4
Non-oil commodities (measured in US$)	-17.3	-5.2	5.7	4.7	-2.9	-1.0
Financial variables						
US$ 3-month commercial paper rate (av; %)	0.2	0.5	0.6	1.4	1.5	1.0
¥ 3-month money market rate (av; %)	0.2	0.3	0.1	0.1	0.1	0.1
Exchange rate: ¥:US$ (av)	121.0	109.3	103.6	107.0	109.0	109.0
Exchange rate: Rs:US$ (av)	64.2	68.4	72.4	73.2	72.3	71.8
Exchange rate: US$:€ (av)	1.11	1.08	1.07	1.12	1.13	1.15

Economic growth

India's economy is well placed to grow at a robust pace throughout the forecast period thanks to strong domestic consumption and, to a lesser extent, government spending on infrastructure. However, stress in the balance sheets of banks and corporates, as well as a difficult business environment, will constrain the pace of private-sector investment in the early part of the forecast period. The contribution of the external sector to headline GDP growth is expected to be neutral over the forecast period, as export growth will remain relatively subdued. Thus, we forecast that the expenditure measure of economic growth will average 7.4% a year in 2016/17-2020/21 on a seasonally adjusted basis.

On the production side, manufacturing and services will drive GDP growth. The manufacturing sector will gradually improve as structural reforms are passed. Government initiatives dedicated to raising manufacturing output (such as the "Make in India" campaign) will also bolster the sector's growth prospects modestly. Steps to liberalise FDI will also have a positive impact on economic activity in manufacturing and services. The share of agriculture in the economy will shrink over the forecast period, but it will remain a source of short-term volatility for GDP growth given the sector's reliance on seasonal monsoon rainfalls.

Although India's growth outlook is generally positive, it appears to be overstated by the official real GDP figures released by the Central Statistical Organisation (CSO). For instance, there are statistical issues related to the estimation of an appropriate price index for the large services sector. Moreover, growth in manufacturing appears overstated by the use of a single rather than double deflator for input and output prices. This is corroborated by a number of local high-frequency economic indicators, which point towards a slower pace of growth than official statistics suggest.

In addition, the CSO's data sources for the factor-cost measure are more comprehensive than those for the expenditure side. To reconcile both measures, large discrepancies have been added to the CSO's expenditure-based gauge of GDP. In view of these issues, significant revisions to the individual components of the national-accounts data cannot be ruled out.

Economic growth

(%; fiscal years beginning Apr 1st)	2015[a]	2016[b]	2017[b]	2018[b]	2019[b]	2020[b]
GDP	7.5	7.6	7.4	7.4	7.3	7.3
Private consumption	7.4	7.8	7.5	7.3	7.1	7.4
Government consumption	2.2	5.1	5.7	6.4	8.8	4.9
Gross fixed investment	4.0	5.6	6.8	7.3	6.3	7.5
Exports of goods & services	-5.2	0.3	3.0	5.1	3.3	5.8
Imports of goods & services	-2.8	0.8	3.5	4.7	2.9	4.0
Domestic demand	5.7	7.1	7.8	7.3	7.0	7.0
Agriculture	1.2	3.7	3.6	3.1	3.6	3.5
Industry	7.4	7.4	7.5	7.5	7.8	7.5
Services	9.9	9.4	8.2	8.5	8.8	9.2

[a] Actual. [b] Economist Intelligence Unit forecasts.

Inflation

We expect consumer price inflation to average 5.3% a year in 2016-20. This will represent a continued moderation as disciplined monetary policy and gradual improvements in tackling supply-side bottlenecks help to tame inflation, which averaged 7.8% a year in 2011-15. Relatively low global commodity prices—which are set to remain well below the peaks seen in 2012 over the forecast period—will also support the RBI's efforts to contain inflation.

Food and beverage products have a weighting of 45.9% in the consumer price index, and so inflation is sensitive to changes in food prices. Owing to some improvements in food-supply management, upside risks to inflation from food price spikes have decreased. Nevertheless, a particularly poor monsoon could result in a temporary spike in inflation.

Exchange rates

We expect the rupee to weaken to Rs68.4:US$1 on average in 2016 and Rs72.4:US$1 in 2017, from Rs64.2:US$1 in 2015. The large merchandise trade deficit and inflation differential with the US will put downward pressure on the local currency in those years. Still, thanks to relatively high levels of foreign-exchange reserves, the central bank will take steps to smooth exchange-rate volatility throughout the forecast period.

We expect the rupee to strengthen modestly against the US dollar from late 2018 as the RBI's tightening of monetary policy and India's robust growth prospects lead to stronger capital and investment inflows. This is in line with our long-held view that the country's relatively healthy macroeconomic outlook will help to minimise the risk of excessive exchange-rate volatility.

Nevertheless, the impending leadership change at the RBI poses downside risks to our forecast and we may adjust our view in the coming months, depending on the selection for the new RBI governor. This is because Mr Rajan's successor may give in to calls from industry and government to bolster the competitiveness of the export sector by allowing the rupee to depreciate. Indeed, research by the RBI indicates that the rupee is significantly overvalued against other emerging-market currencies on an inflation-adjusted basis.

External sector

A large merchandise trade deficit means that the current account will remain in the red over the forecast period, albeit to a lesser extent than in the past. We forecast that the current-account deficit will average the equivalent of 1.3% of GDP in 2016-20, much lower than the 2.7% average recorded in the previous five-year period. To a large extent this reduction is the result of relatively low commodity prices, which have reduced India's import bill.

The bulk of India's foreign-exchange receipts will continue to be furnished by the services sector, as well as in the form of workers' remittances. However, growth in services exports will become harder to achieve as the business process outsourcing (BPO) sector comes up against increasingly intense competition at a time when companies are rethinking their approach to BPO. Moreover, a drop in demand for transport services will also depress growth in services exports.

Forecast summary

Forecast summary

(% unless otherwise indicated)

	2015[a]	2016[b]	2017[b]	2018[b]	2019[b]	2020[b]
Real GDP growth[c]	7.5	7.6	7.4	7.4	7.3	7.3
Industrial production growth[c]	3.2	2.9	5.5	6.5	7.7	7.2
Unemployment rate (av)	8.4[d]	8.4	8.5	8.5	8.3	8.4
Consumer price inflation (av)	4.9	5.6	5.7	5.3	4.9	4.9
Consumer price inflation (end-period)	5.7	5.9	5.8	4.8	4.9	4.9
Short-term interbank rate	10.0	9.3	9.1	9.4	9.3	9.2
Government balance (% of GDP)[c]	-3.9	-3.8	-3.6	-3.5	-3.9	-3.7
Exports of goods fob (US$ bn)	272	270	294	318	324	340
Imports of goods fob (US$ bn)	-409	-401	-440	-484	-508	-532
Current-account balance (US$ bn)	-22.4	-19.6	-30.6	-39.1	-47.3	-47.4
Current-account balance (% of GDP)	-1.1	-0.9	-1.3	-1.5	-1.6	-1.4
Total foreign debt (US$ bn; year-end)	480.8[d]	507.4	531.2	549.8	572.6	594.5
Exchange rate Rs:US$ (av)	64.15	68.39	72.38	73.19	72.28	71.78
Exchange rate Rs:US$ (end-period)	66.33	71.00	73.38	73.29	71.68	71.17
Exchange rate Rs:¥100 (av)	53.01	62.57	69.83	68.40	66.31	65.85
Exchange rate Rs:€ (av)	71.18	74.06	77.63	81.61	81.86	82.18

[a] Actual. [b] Economist Intelligence Unit forecasts. [c] Fiscal years (beginning April 1st of year indicated). [d] Economist Intelligence Unit estimates.

Quarterly forecasts

Quarterly forecasts

	2015				2016				2017			
	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr
GDP												
% change, quarter on quarter	1.7	2.5	1.9	1.2	2.3	2.0	2.0	0.9	2.6	1.8	2.0	0.9
% change, year on year	7.2	7.2	7.1	7.5	8.2	7.7	7.7	7.4	7.7	7.4	7.5	7.5
Private consumption												
% change, quarter on quarter	4.0	2.0	1.3	1.2	3.4	1.8	1.8	0.7	2.4	1.9	2.2	1.0
% change, year on year	6.5	6.7	6.0	8.7	8.1	8.0	8.5	7.9	6.9	7.0	7.4	7.7
Government consumption												
% change, quarter on quarter	-11.2	6.9	2.9	3.0	-6.5	3.4	3.3	2.2	3.7	0.4	0.7	-0.4
% change, year on year	-0.7	-0.4	3.0	0.7	5.9	2.5	2.9	2.1	13.2	9.9	7.2	4.4
Gross fixed investment												
% change, quarter on quarter	0.5	4.5	1.8	-5.3	-2.8	4.3	4.1	3.0	4.4	0.4	0.7	-0.4
% change, year on year	5.3	7.1	9.6	1.3	-2.0	-2.2	0.0	8.7	16.7	12.3	8.7	5.1
Exports of goods & services												
% change, quarter on quarter	-4.8	0.2	-2.3	-2.0	2.1	0.3	0.3	-0.8	0.8	1.1	1.4	0.2
% change, year on year	-6.5	-5.8	-4.4	-8.6	-1.9	-1.9	0.7	1.9	0.6	1.4	2.5	3.6
Imports of goods & services												
% change, quarter on quarter	-4.6	2.9	0.2	-4.5	0.8	1.2	1.1	0.1	1.7	0.8	1.1	-0.1
% change, year on year	-5.4	-2.6	-1.5	-6.1	-0.9	-2.5	-1.5	3.2	4.2	3.7	3.7	3.5
Domestic demand												
% change, quarter on quarter	1.2	3.4	1.6	-0.8	0.4	2.9	2.8	1.7	3.3	1.5	1.8	0.6
% change, year on year	5.6	6.0	6.9	5.4	4.6	4.1	5.3	7.9	11.0	9.5	8.4	7.3
Consumer prices												
% change, quarter on quarter	1.5	1.4	0.7	1.6	1.4	1.4	1.5	1.3	1.4	1.3	1.3	1.8
% change, year on year	5.3	5.1	3.9	5.4	5.3	5.3	6.0	5.7	5.7	5.6	5.5	6.0
Producer prices												
% change, quarter on quarter	-1.8	0.1	-1.4	0.8	-0.3	0.8	0.5	1.1	0.9	0.9	0.5	1.2
% change, year on year	-1.7	-2.3	-4.6	-2.3	-0.7	0.0	1.9	2.2	3.4	3.5	3.5	3.6
Exchange rate Rs:US$												
Average	62.2	63.5	65.0	65.9	67.5	67.0	68.5	70.6	71.4	71.5	72.4	74.2
End-period	62.6	63.8	65.7	66.3	66.3	67.7	69.6	71.0	71.5	72.0	73.3	72.8
Interest rates (%; av)												
Money market rate	8.6	8.2	7.8	7.4	7.9	7.3	7.2	7.1	7.9	7.1	7.1	7.3
Long-term bond yield	7.8	7.9	7.5	8.1	7.4	7.5	7.5	7.5	7.4	7.8	8.0	8.0

Data and charts

Annual data and forecast

	2011[a]	2012[a]	2013[a]	2014[a]	2015[a]	2016[b]	2017[b]
GDP[c]							
Nominal GDP (US$ bn)	1,820	1,828	1,862	2,042	2,072	2,163	2,320
Nominal GDP (Rs bn)	87,222	99,448	112,673	124,849	135,653	149,251	168,043
Real GDP growth (%)	5.6	5.7	6.7	7.2	7.5	7.6	7.4
Expenditure on GDP (% real change)[c]							
Private consumption	2.0	5.3	6.7	6.3	7.4	7.8	7.5
Government consumption	30.5	-0.6	0.2	12.8	2.2	5.1	5.7
Gross fixed investment	15.3	4.8	3.5	4.8	4.0	5.6	6.8
Exports of goods & services	11.2	6.8	7.7	1.8	-5.2	0.3	3.0
Imports of goods & services	17.8	6.1	-8.1	0.8	-2.8	0.8	3.5
Origin of GDP (% real change)[c]							
Agriculture	5.0	1.5	4.2	-0.2	1.2	3.7	3.6
Industry	7.8	3.6	5.0	5.9	7.4	7.4	7.5
Services	6.6	10.0	8.6	11.6	9.9	9.4	8.2
Population and income							
Population (m)	1,247	1,264	1,279	1,295	1,311	1,327	1,343
GDP per head (US$ at PPP)	4,627	4,928	5,267	5,676	6,090[d]	6,586	7,121
Fiscal indicators (% of GDP)[c]							
Central government revenue	9.0	9.2	9.4	9.2	9.1	9.2	9.6
Central government expenditure	14.9	14.2	13.8	13.2	13.1	13.0	13.2
Central government balance	-5.8	-4.9	-4.5	-4.0	-3.9	-3.8	-3.6
Net public debt	53.5	52.5	52.0	51.9	52.4	52.2	50.7
Prices and financial indicators							
Exchange rate Rs:US$ (av)	46.67	53.44	58.60	61.03	64.15	68.39	72.38
Consumer prices (av; % change)	8.3	9.4	9.9	6.7	4.9	5.6	5.7
Producer prices (av; % change)	9.5	7.5	6.3	3.8	-2.7	0.8	3.5
Stock of money M1 (% change)	6.7	6.8	9.8	10.0	12.3	12.1	11.6
Stock of money M2 (% change)	16.0	11.2	14.8	10.7	10.7	9.2	10.1
Lending interest rate (av; %)	10.2	10.6	10.3	10.3	10.0	9.3	9.1
Current account (US$ m)							
Trade balance	-167,449	-201,666	-162,577	-144,048	-136,885	-130,971	-145,979
Goods: exports fob	307,836	301,853	319,719	328,387	272,353	270,288	293,949
Goods: imports fob	-475,285	-503,519	-482,296	-472,433	-409,238	-401,258	-439,929
Services balance	60,778	65,604	70,320	76,077	73,716	70,313	75,223
Primary income balance	-16,043	-20,842	-21,785	-24,945	-23,378	-26,180	-27,480
Secondary income balance	60,211	65,434	64,814	65,601	64,154	67,194	67,668
Current-account balance	-62,503	-91,470	-49,228	-27,316	-22,393	-19,643	-30,568
External debt (US$ m)							
Debt stock	336,845	395,071	429,742	463,230	480,826[d]	507,429	531,171
Debt service paid	29,332	30,775	38,829	92,519	47,329[d]	52,866	60,631
Principal repayments	22,227	21,202	28,931	80,937	35,831[d]	39,717	47,131
Interest	7,105	9,574	9,897	11,582	11,497[d]	13,149	13,500
International reserves (US$ m)							
Total international reserves	297,905	297,807	296,218	322,833	351,551	358,658	359,529

[a] Actual. [b] Economist Intelligence Unit forecasts. [c] Fiscal years (beginning April 1st of year indicated). [d] Economist Intelligence Unit estimates.

Source: IMF, International Financial Statistics.

Quarterly data

	2014		2015				2016	
	3 Qtr	4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr	2 Qtr
Central government finance (Rs m)								
Revenue	3,075	2,808	4,389	1,443	3,877	2,938	4,151	n/a
Expenditure	4,485	3,743	4,084	4,310	4,796	4,035	4,593	n/a
Balance	-1,410	-936	305	-2,867	-919	-1,096	-442	n/a
Output								
GDP at constant 2004/05 prices (Rs bn)[a]	26,306	26,519	26,970	27,647	28,178	28,513	29,174	n/a
Real GDP (% change, year on year)	7.6	6.9	7.2	7.2	7.1	7.5	8.2	n/a
Industrial production index (2004/05=100)	170.3	174.4	189.4	179.0	178.4	177.3	189.8	n/a
Industrial production (% change, year on year)	1.3	2.0	3.3	3.3	4.8	1.7	0.2	n/a
Prices								
Consumer prices (2010=100)	118.8	119.1	120.9	122.6	123.5	125.5	127.2	n/a
Consumer prices (% change, year on year)	6.7	4.1	5.3	5.1	3.9	5.4	5.3	n/a
Wholesale prices (2004/05=100)								
General index	183.9	181.0	177.8	177.9	175.5	176.9	176.5	177.9
Fuel	214.0	201.8	186.1	190.0	181.6	177.1	170.4	n/a
Manufactured goods	156.0	155.3	154.1	154.1	153.3	152.9	153.3	n/a
Financial indicators								
Exchange rate Rs:US$ (av)	60.6	61.9	62.2	63.5	65.0	65.9	67.5	n/a
Exchange rate Rs:US$ (end-period)	61.6	63.3	62.6	63.8	65.7	66.3	66.3	n/a
Deposit rate (av; %)	9.1	9.0	8.8	8.6	8.2	7.9	7.9	n/a
Lending rate (av; %)	10.3	10.3	10.3	10.1	10.0	9.7	9.7	n/a
3-month money market rate (av; %)	8.9	8.7	8.6	8.2	7.8	7.4	7.9	7.3
M1 (end-period; Rs bn)[b]	21,142	21,886	22,924	23,448	23,491	24,576	26,050	n/a
M1 (% change, year on year)	10.7	10.0	11.3	9.2	11.1	12.3	13.6	n/a
M2 (end-period; Rs bn)[b]	99,317	102,108	105,502	108,111	109,902	113,004	116,488	n/a
M2 (% change, year on year)	12.4	10.7	10.9	10.6	10.7	10.7	10.4	n/a
BSE Sensex (end-period; 1978/79=100)	26,631	27,499	27,957	27,781	26,155	26,118	25,342	n/a
BSE Sensex (% change, year on year)	37.4	29.9	24.9	9.3	-1.8	-5.0	-9.4	n/a
Sectoral trends								
Production index (2004/05=100)								
Manufacturing	179.2	182.2	201.2	188.4	187.5	184.3	199.0	n/a
Mining	115.5	128.8	138.4	123.8	119.1	133.0	141.5	n/a
Electricity	181.2	178.9	173.0	185.3	193.5	186.8	189.1	n/a
Foreign trade (US$ m)								
Exports fob	81,531	78,591	70,457	66,980	66,638	63,523	64,701	n/a
Imports cif	-120,883	-117,525	-96,419	-99,795	-102,361	-95,088	-83,031	n/a
Trade balance	-39,352	-38,934	-25,962	-32,815	-35,723	-31,565	-18,329	n/a
Foreign payments (US$ m)[b]								
Merchandise trade balance fob-fob	-39,652	-38,634	-31,561	-34,175	-37,173	-33,976	-24,755	n/a
Services balance	18,929	19,982	20,117	17,751	17,835	18,013	16,077	n/a
Primary income balance	-6,610	-5,497	-5,625	-5,861	-5,484	-6,408	-6,621	n/a
Net transfer payments	16,404	16,441	16,445	16,166	16,283	15,260	14,982	n/a
Current-account balance	-10,928	-7,709	-625	-6,119	-8,539	-7,112	-318	n/a
Reserves excl gold (end-period)	296,204	303,455	323,825	338,107	333,345	334,311	341,189	n/a

[a] At market prices. [b] Reserve Bank of India.

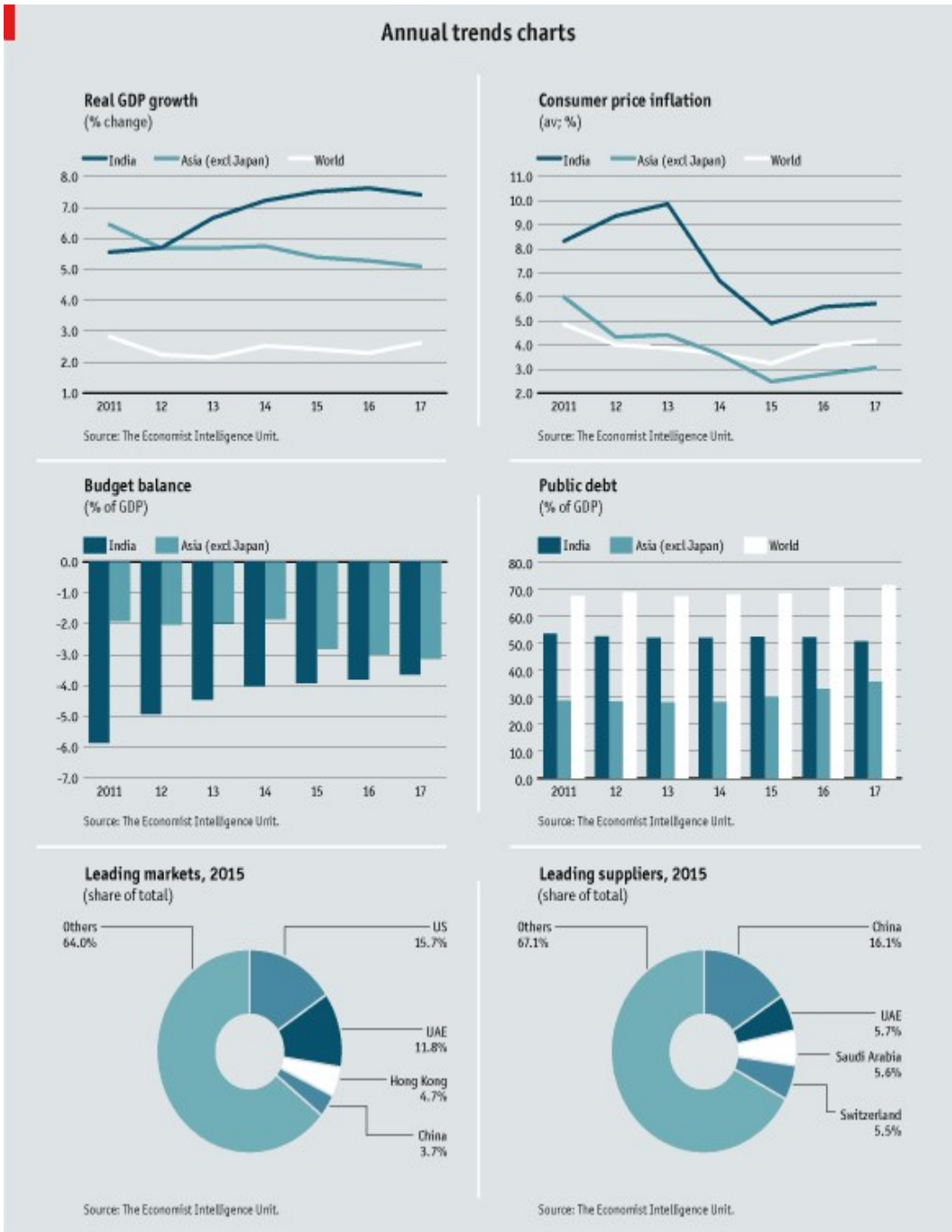
Sources: IMF, International Financial Statistics; Centre for Monitoring Indian Economy, Monthly Review of the Indian Economy; Financial Times; Reserve Bank of India.

Monthly data

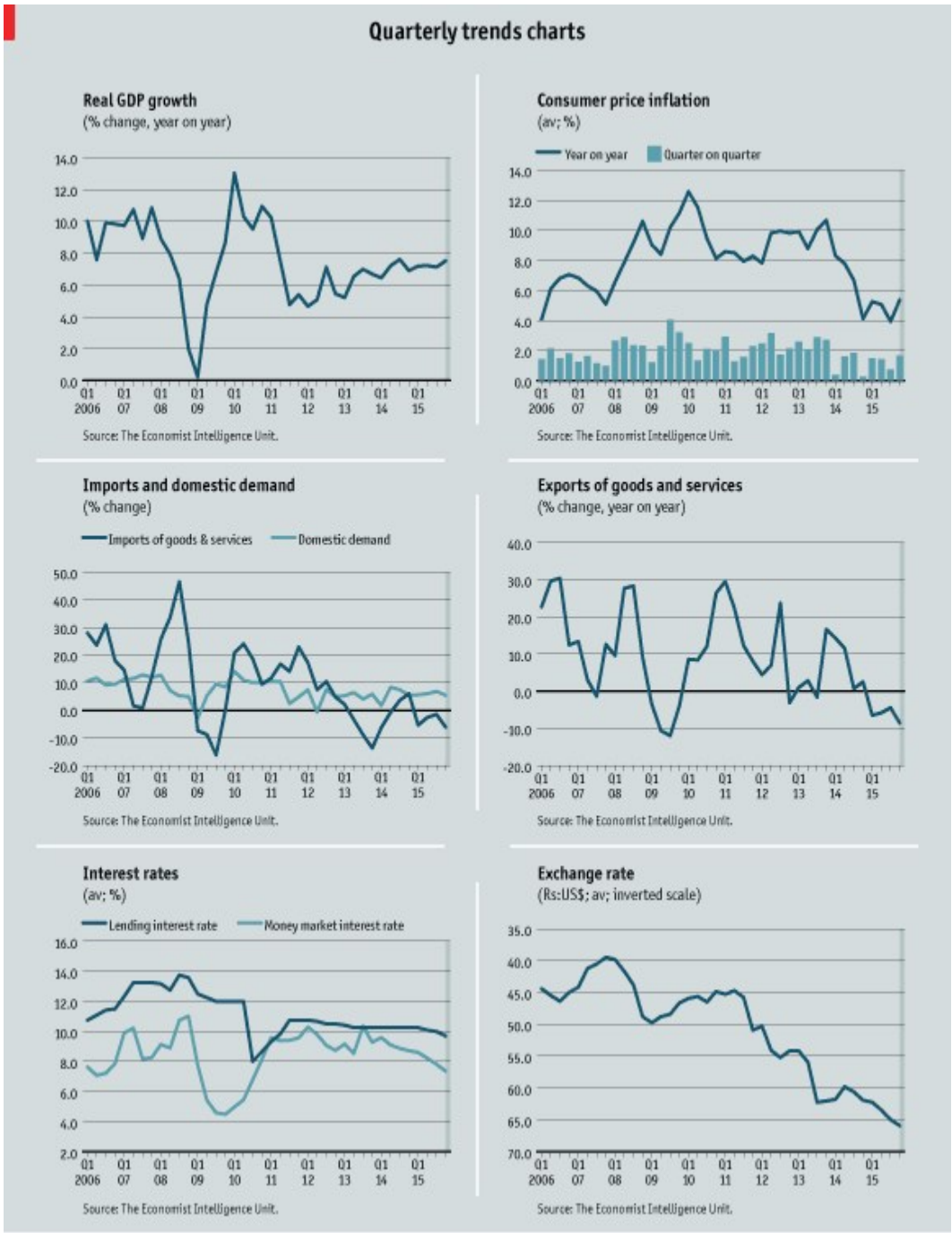
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Exchange rate Rs:US$ (av)												
2014	62.1	62.3	61.0	60.4	59.3	59.7	60.1	60.9	60.9	61.3	61.7	62.8
2015	62.2	62.0	62.4	62.8	63.8	63.9	63.6	65.1	66.2	65.1	66.1	66.6
2016	67.3	68.2	67.0	66.5	66.9	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Exchange rate Rs:US$ (end-period)												
2014	62.5	62.1	60.1	60.3	59.0	60.1	60.2	60.5	61.6	61.4	62.0	63.3
2015	61.8	61.8	62.6	63.6	63.8	63.8	64.0	66.3	65.7	65.2	66.8	66.3
2016	67.9	68.6	66.3	66.5	67.2	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Money supply M1 (% change, year on year)												
2014	11.3	9.6	8.5	11.5	12.2	8.9	10.5	10.9	10.7	11.4	10.5	10.0
2015	9.0	10.7	11.3	10.2	9.7	9.2	10.7	10.9	11.1	11.8	11.6	12.3
2016	11.5	13.4	13.6	14.5	12.4	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Money supply M3 (% change, year on year)												
2014	14.5	14.6	13.4	13.9	13.2	11.8	12.4	12.8	12.4	12.4	10.7	10.7
2015	10.8	11.2	10.9	10.8	10.8	10.6	11.1	11.1	10.7	10.6	10.4	10.7
2016	10.8	11.4	10.4	11.0	10.1	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Money market rate (end-period; %)												
2014	9.21	9.63	9.93	9.30	9.11	8.90	8.79	8.92	8.91	8.85	8.68	8.62
2015	8.56	8.64	8.61	8.29	8.31	8.06	7.95	7.79	7.73	7.28	7.36	7.42
2016	7.57	8.07	8.19	7.29	7.30	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Lending rate (av; %)												
2014	10.3	10.3	10.3	10.3	10.3	10.3	10.3	10.3	10.3	10.3	10.3	10.3
2015	10.3	10.3	10.3	10.3	10.0	10.0	10.0	10.0	10.0	9.7	9.7	9.7
2016	9.7	9.7	9.7	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Industrial production (% change, year on year)												
2014	1.1	-2.0	-0.5	3.7	5.6	4.3	0.9	0.5	2.6	-2.7	5.2	3.6
2015	2.8	4.8	2.5	3.0	2.5	4.2	4.3	6.3	3.7	9.9	-3.4	-0.9
2016	-1.6	2.0	0.3	-0.8	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
BSE Sensex stockmarket index (end-period; 1978/79=100)												
2014	20,514	21,120	22,386	22,418	24,217	25,414	25,895	26,638	26,631	27,866	28,694	27,499
2015	29,183	29,220	27,957	27,011	27,828	27,781	28,115	26,283	26,155	26,657	26,146	26,118
2016	24,871	23,002	25,342	25,607	26,668	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Consumer prices (% change, year on year; av)												
2014	8.8	7.9	8.2	8.5	8.2	6.7	7.3	7.0	5.7	4.7	3.3	4.4
2015	5.2	5.4	5.2	4.8	5.0	5.4	3.5	3.9	4.5	4.9	5.5	5.7
2016	5.7	5.3	4.8	5.4	5.7	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Wholesale prices (% change, year on year; av)												
2014	5.2	5.1	6.1	5.7	6.1	5.5	5.4	3.8	2.4	1.7	-0.2	-0.4
2015	-0.8	-2.0	-2.3	-2.4	-2.2	-2.2	-4.2	-5.0	-4.6	-3.8	-1.9	-1.1
2016	-1.0	-0.8	-0.5	0.3	0.7	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Total exports fob (US$ m)												
2014	26,892	25,353	30,341	25,828	28,019	25,927	25,816	26,825	28,890	25,915	26,503	26,173
2015	24,415	22,008	24,034	22,112	22,347	22,521	23,291	21,556	21,791	21,420	19,551	22,552
2016	21,101	20,807	22,793	20,648	22,171	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Total imports cif (US$ m)												
2014	36,346	33,666	41,294	35,796	39,059	38,352	40,068	37,473	43,342	39,469	42,722	35,333
2015	32,265	28,725	35,429	33,506	32,753	33,536	36,371	33,976	32,014	31,151	29,858	34,078
2016	28,764	27,271	26,995	25,414	28,444	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Trade balance fob-cif (US$ m)												
2014	-9,455	-8,312	-10,953	-9,968	-11,040	-12,426	-14,252	-10,647	-14,452	-13,554	-16,219	-9,160
2015	-7,850	-6,717	-11,395	-11,394	-10,406	-11,015	-13,080	-12,420	-10,223	-9,732	-10,308	-11,526
2016	-7,663	-6,465	-4,202	-4,766	-6,273	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Foreign-exchange reserves excl gold (US$ m)												
2014	273,388	275,731	285,032	292,402	293,862	298,024	301,132	299,916	296,204	298,473	298,852	303,455
2015	310,607	319,300	323,825	333,726	334,318	338,107	336,337	334,621	333,345	336,654	333,852	334,311
2016	333,078	330,199	341,189	344,141	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a

Sources: IMF, International Financial Statistics; Haver Analytics.

Annual trends charts

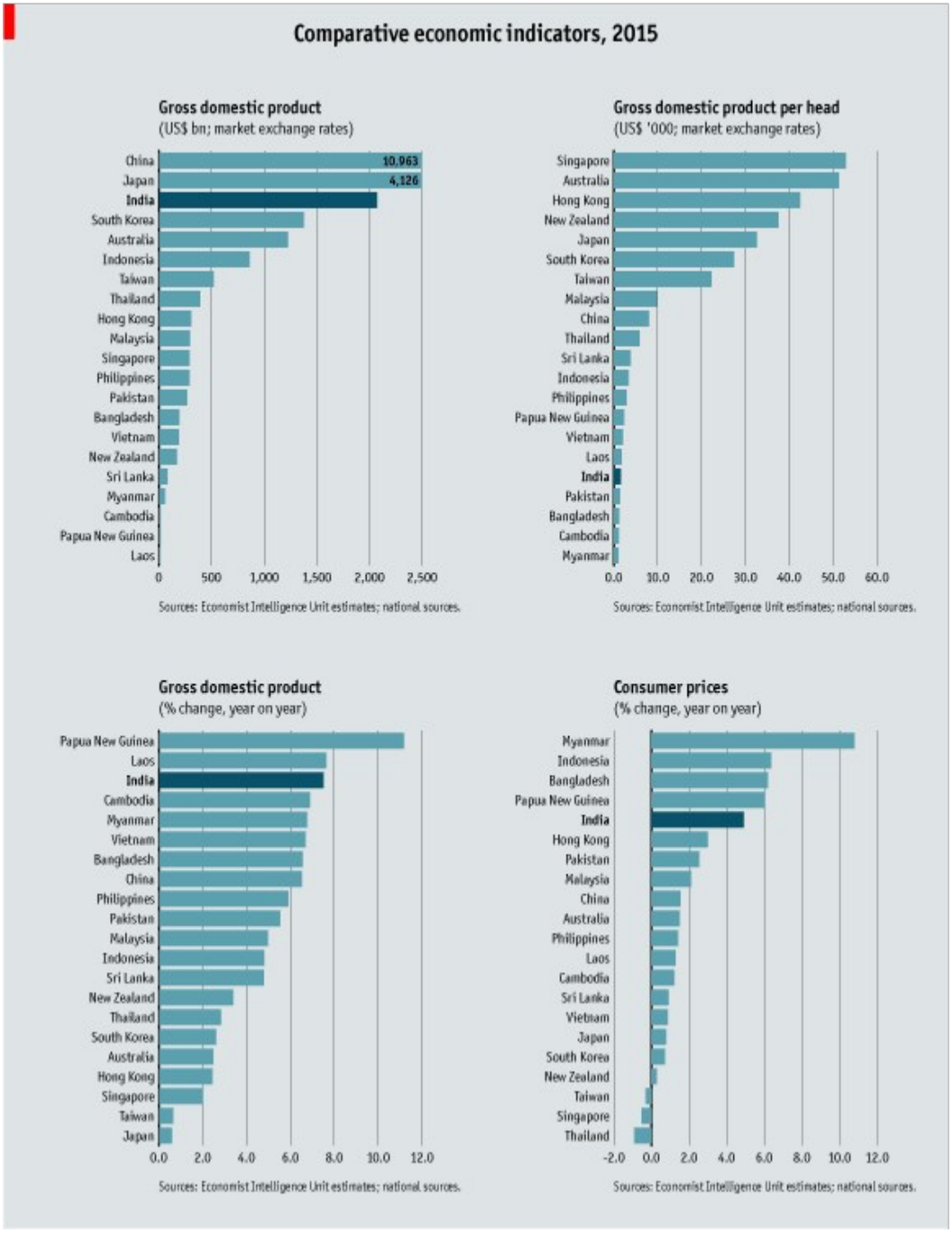


Quarterly trends charts



Monthly trends charts

Comparative economic indicators



Basic data

Land area

3,287,263 sq km (including Indian-administered Kashmir); of the total, 57% is agricultural land and 16% is forest area

Population

1.31bn (2015; UN)

Main towns

Population in millions of metropolitan areas/regions (2011 census)

New Delhi (capital): 21.8

Mumbai (Bombay): 20.8

Kolkata (Calcutta): 14.6

Chennai (Madras): 8.9

Bangalore: 8.7

Hyderabad: 7.7

Climate

Varied: humid subtropical in Ganges basin, semi-arid in the north-west, tropical humid in north-east and most of the peninsula, tundra in the Himalayas. All areas receive rain from the south-west monsoon in June-September; the south is also served by the north-east monsoon in January-March

Weather in New Delhi (altitude 218 metres)

Hottest month, May, 26-41°C (average daily minimum and maximum); coldest month, January, 7-21°C; driest month, November, 4 mm average rainfall; wettest month, July, 180 mm average rainfall

Languages

Hindi is the official language and the primary tongue of 30% of the population. English is an additional language used for official purposes and also used widely in business circles. Individual states may legislate their own official language, and several have done so

Religions

Hindu (79.8% in 2011 census); Muslim (14.2%); Christian (2.3%); Sikh (1.7%); Buddhist (0.7%); Jain (0.4%)

Measures

Metric system. Numbers are often written in lakhs (100,000) and crores (10m)

Currency

Rupee (Rs); Rs1 = 100 paisa. Average exchange rate in 2015: Rs64.15:US$1

Fiscal year

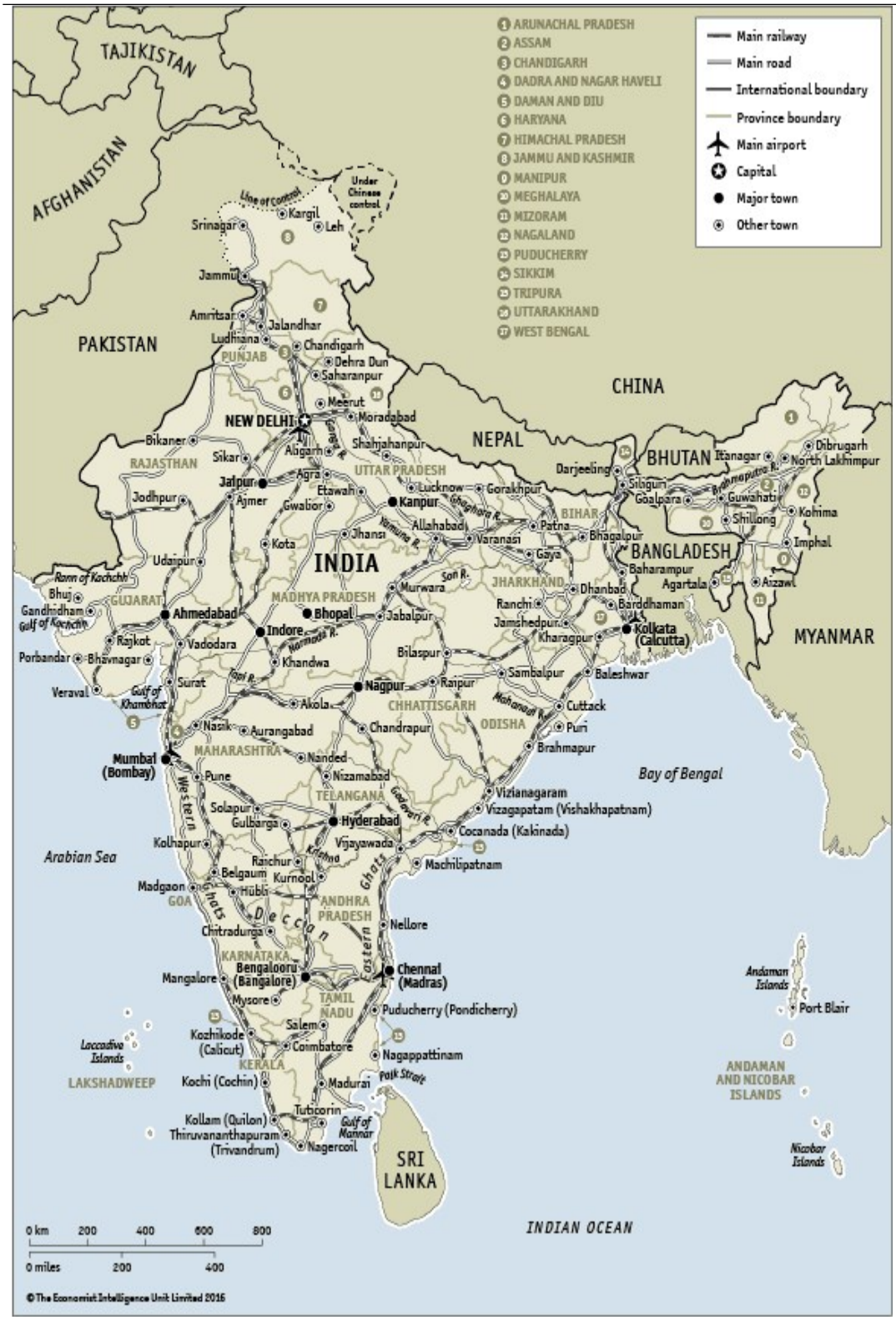
April 1st-March 31st

Time

5 hours 30 minutes ahead of GMT

Public holidays

Republic Day (January 26th); Independence Day (August 15th); Mahatma Gandhi's birthday (October 2nd); also major Hindu, Muslim, Christian and other religious holidays



Political structure

Official name

Republic of India

Form of state

Federal republic, with 29 states and seven union territories

Head of state

The president, Pranab Mukherjee, was elected in July 2012 for a five-year term by the members of the central and state legislatures

The executive

The prime minister presides over a Council of Ministers chosen from the elected members of parliament (MPs)

National legislature

Bicameral. The Lok Sabha (the lower house) has 545 members—543 elected from single-member constituencies (79 seats are reserved for "scheduled castes" and 40 for "scheduled tribes") and two representatives of Anglo-Indians appointed by the president. The Rajya Sabha (the upper house) has 245 members—233 elected by weighted votes of the elected MPs and the legislative assemblies of states and union territories, and 12 appointed by the president

State legislatures

Unicameral or bicameral, with elected members; state governors are appointed by the president

Legal system

Based on the 1950 constitution and English common law

National government

The National Democratic Alliance, a coalition led by the Bharatiya Janata Party (BJP), won the largest number of seats at the parliamentary election held in April-May 2014 and formed a government

National election

The most recent Lok Sabha election was held in April-May 2014; the next is due to take place by May 2019

Main political organisations

BJP; Indian National Congress; All India Anna Dravida Munnetra Kazhagam (AIADMK); Trinamool Congress (TMC); Biju Janata Dal (BJD); Shiv Sena (SHS); Telugu Desam Party (TDP); Telangana Rashtra Samithi (TRS); Communist Party of India (Marxist), or CPI (M); YSR Congress Party (YSRCP); Nationalist Congress Party (NCP); Lok Janshakti Party (LJP); Samajwadi Party (SP); Aam Aadmi Party (AAP); Rashtriya Janata Dal (RJD); Janata Dal (United); Bahujan Samaj Party (BSP); Dravida Munnetra Kazhagam (DMK)

Key ministers

Prime minister: Narendra Modi (BJP)

Agriculture: Radha Mohan Singh (BJP)

Civil aviation: Ashok Gajapathi Raju Pusapati (TDP)

Communications & information technology: Ravi Shankar Prasad (BJP)

Defence: Manohar Parrikar (BJP)

External affairs: Sushma Swaraj (BJP)

Finance: Arun Jaitley (BJP)

Health & family welfare: Jagat Prakash Nagga (BJP)

Home affairs: Rajnath Singh (BJP)

Power & coal: Piyush Goyal (BJP)

Railways: Suresh Prabhu (BJP)

Rural development: Chaudhary Birender Singh (BJP)

Urban development: Venkaiah Naidu (BJP)

Central bank governor

Raghuram Rajan

Recent analysis

Generated on July 13th 2016

The following articles were published on our website in the period between our previous forecast and this one, and ser a review of the developments that shaped our outlook.

Politics

Forecast updates

June 9, 2016: International relations

Modi reaffirms commitment to US-Indian relations

Event

On a three-day state visit to the US, India's prime minister, Narendra Modi, restated his administration's commitment to deepening bilateral business and defence ties.

Analysis

Mr Modi completed his fourth state visit to the US on June 9th. The three-day visit was designed to take stock of US-Indian relations and celebrate ties that have deepened significantly since Mr Modi took office in May 2014. The Indian prime minister addressed the US Congress, met the president, Barack Obama, and formalised agreements covering climate change, renewable energy, security and economic issues. The closer relationship between the world's biggest and its oldest democracy is largely a result of shifting geopolitics, amid the US's foreign policy pivot to Asia and India's concerns about China's rising influence in its neighbourhood.

In his speech to Congress, Mr Modi laid out the two nations' common strategic interests: a stable Afghanistan, the fight against terrorism emanating from "India's neighbourhood" (a reference to Pakistan, India's historic foe) and maritime security in the Indian Ocean. Denying China unfettered access to a second ocean—the mark of a naval superpower—is key for both India and the US, a large naval power in Asia.

Mr Modi also reiterated that India is open for business, although he has fallen short on delivering the big-bang liberalisation of trade and foreign investment that many US companies had hoped for. Even so, bilateral trade between the US and India has risen from US$60bn in 2009 to US$109bn in 2015, according to figures from the US Census Bureau, and is likely to continue rising over the next five years. A US firm, Westinghouse, is in negotiations to build six nuclear power stations in India, while the US is selling billions of dollars' worth of military equipment to India, which is one of the biggest and fastest-growing defence markets.

Mr Modi's timidity in delivering more of what the US wants—especially market access—reflects domestic political constraints. His government lacks a majority in the Rajya Sabha (the upper house of parliament), and pushing through radical reforms would burn the political capital he needs to secure a second term in office. The main message Mr Modi carried to his hosts was that under his watch, ties will remain close.

Impact on the forecast

Mr Modi's visit is consistent with our expectation that US-Indian ties will strengthen in response to China's rising influence in South Asia and the two countries' common interest in stabilising Afghanistan and Pakistan.

Economy

Forecast updates

June 2, 2016: Fiscal policy outlook

Government narrowly meets budget deficit target for 2015/16

Event

According to data released by the Ministry of Finance on May 31st, the government met its budget deficit target for fiscal year 2015/16 (April–March), which had been set at the equivalent of 3.9% of nominal GDP.

Analysis

The data are in line with The Economist Intelligence Unit's estimates. However, a closer look at the data shows that the government only just managed to meet its target: the deficit stood at the equivalent of 3.92% of GDP, and so only a minor reduction in revenue or increase in spending would have caused a narrow miss. On a positive note, the government appears to have met its divestment target for 2015/16, but this comes with the caveat that the target itself had been by more than half late in the fiscal year.

Nevertheless, the budget deficit has been shrinking for several years and is set to narrow further in 2016/17. The government has set itself the goal of reducing the fiscal shortfall to the equivalent of 3.5% of GDP in 2016/17, with the intent of lowering borrowing costs for itself (through lower bond yields) and across the economy as a whole (it hopes that a commitment to fiscal consolidation will spur cuts in key policy interest rates by the Reserve Bank of India, the central bank). Although we believe that the budget deficit will narrow again in 2016/17, we are less sanguine about the size of the reduction, as the administration's plans rest on a challenging fiscal arithmetic, including highly ambitious divestment revenue targets.

Data for the month of April show that the budget deficit was equivalent to about 25% of the target for the entire fiscal year. However, this is not a cause for concern as hefty budget deficits in the early part of the fiscal year are common for India's public finances. This is because tax revenue streams are back-loaded, seeing a huge spike at the end of the fiscal year in March.

Impact on the forecast

The development is in line with our view. We maintain our forecast of a budget deficit equivalent to 3.8% of nominal GDP in 2016/17.

June 2, 2016: External sector

Government rolls back controversial gold tax plan

Event

With effect from June 1st, the Indian government has rolled back a proposed 1% tax on cash transactions for gold jewellery worth over Rs200,000 (US$3,000) and kept the limit at an earlier threshold of Rs500,000.

Analysis

In scrapping the controversial tax decision, the Indian government has suffered a setback in its efforts to regulate the country's large gold market. The transaction tax was originally introduced in the budget for fiscal year 2016/17 (April-March). It triggered an outcry among jewellery traders, who embarked on a 42-day strike in protest at the government's plans to tighten the grip of India's tax bureaucracy on what remains a largely unregulated sector. According to some industry estimates, Indian households and temples privately hold gold worth US$1trn.

The rollback illustrates the difficulty of taxing a commodity that Indian consumers value so highly. Gold is an important part of household savings, and Indian consumers are highly price-sensitive. In the first quarter of 2016 Indian gold demand fell by 44% year on year to a seven-year low of 88.4 tonnes. In part the drop in demand reflects rising prices. However, another reason was that gold traders had stopped importing gold in the run-up to the February budget because they expected the government to scrap a 10% import duty on the precious metal. (In the end the government kept the import tax unchanged and broadened the transaction tax on gold.)

The Indian government is unlikely to give up easily, however. Strong demand for gold has historically been a major drag on the country's external accounts. In November policymakers announced an eight-year sovereign gold bond scheme to encourage people to buy gold certificates rather than physical gold, in a bid to stem imports. Financial inclusion (only one-third of people have bank accounts) is another way to reduce appetite for gold. But this will only go that far; according to government estimates, gold demand is particularly strong among the country's high-earners.

Impact on the forecast

The Economist Intelligence Unit expects the government to continue to look for ways to reduce gold imports and to increase efforts to bring the gold and jewellery sector into the tax net.

June 6, 2016: Economic growth

Manufacturing and services PMI soften in May

Event

Data released in early June by a financial information company, Markit Economics, showed that the Nikkei/Markit India manufacturing purchasing managers' index (PMI) rose modestly in May, to 50.7 points (from 50.5 points in April). A survey for the services sector showed a reading of 51 points in May, down from 53.7 in April.

Analysis

The overall pace of expansion in India's services and manufacturing sectors slowed to its lowest level since November 2015, according to the two separate PMI surveys. However, both remained above the 50-point mark that separates growth from contraction. The data again contrast with those in India's national accounts, which show that the economy raced ahead by 7.9% in January-March, with manufacturing output rising by 9%.

The PMI survey suggests that the manufacturing sector is suffering from rising input prices, which turned positive in April after falling for 17 months. Weak demand for Indian exports also acts as a constraint on growth in manufacturing, according to the survey. Indeed, the index component measuring new business from abroad fell for the first time since September 2013. In the absence of strong foreign demand, India's large domestic market will continue to be a source of relative strength for manufacturers.

As the services sector is roughly three times as large as manufacturing (in terms of contribution to total output), trends in the tertiary sector tend to be of higher significance for overall economic outlook. While the decline in May is of concern, businesses remain optimistic of more activity later in 2016, as stronger consumption spending is expected to result in higher demand for services. This should also help reduce spare capacity in the services sector, which is acting as a drag on earnings growth.

Impact on the forecast

The development is consistent with our economic forecast. We expect economic growth in 2016/17 to remain broadly flat compared with 2015/16, when the economy grew by 7.6% on an expenditure basis.

June 8, 2016: Monetary policy outlook

RBI keeps policy rates on hold

Event

Following its bi-monthly meeting on June 7th, the Reserve Bank of India (RBI, the central bank) kept its main policy interest rate, the repurchase (repo) rate, unchanged at 6.5%. The reverse repo rate was also kept unchanged at 6%.

Analysis

The decision is in line with The Economist Intelligence Unit's view. We expected the RBI to keep interest rates stable at its June meeting for three reasons. First, the RBI has cut interest rates by a cumulative 150 basis points since January 2015, but banks have not fully passed on lower funding costs to borrowers. As a result, the RBI remains keen to encourage monetary transmission before cutting policy rates further. Second, the current governor, Raghuram Rajan, wants to maintain a real interest rate of 1.5-2%. With consumer price inflation at 5.4% year on year in April, that limits the RBI's leeway to cut. Third, even though above-average rainfalls are expected to bolster the agricultural sector (and thereby help contain food prices) in 2016, the RBI has announced that it will wait to judge the impact of monsoon rainfalls over the coming weeks.

We expect the RBI to stay put at its next monetary policy meeting on August 9th. Even with above-average rainfalls, another rate cut would make it difficult for the RBI to meet its consumer price inflation target of 5% by early 2017. Moreover, with the Federal Reserve (the US central bank) expected to raise interest rates twice during the remainder of 2016, the headway for the RBI to ease further will be limited.

Over the coming weeks market speculation over the renewal of Mr Rajan's term in office is expected to pick up. Mr Rajan has played an instrumental role in stabilising the macroeconomic environment and pushing inflation expectations lower. His term is set to end in September but is likely to be renewed for another two years. In the unlikely event that Mr Rajan were to be replaced, currency volatility would rise and capital inflows into India's bond market could weaken.

Impact on the forecast

The development was consistent with our view. We forecast no further cut in the repo rate even as the RBI maintains an accommodative monetary policy stance in 2016.

June 16, 2016: Inflation

Government to tackle rising food prices

Event

According to local media reports, the government decided to increase imports of pulses following a high-level meeting on rising food prices on June 15th.

Analysis

Six senior cabinet ministers, including the finance minister, Arun Jaitley, were at the meeting, which came following growing public and government concern over high food prices. Inflation in India is heavily influenced by food price fluctuations. Food and beverages have a weighting of 45.9% in the consumer price index, while food articles and products have a weighting of 24.4% in the wholesale price index. Two consecutive years of below-average rainfalls leading to poor harvests have adversely affected the primary sector and put upward pressure on food prices.

The government's efforts are also designed to help the Reserve Bank of India (RBI, the central bank) to meet its target of bringing consumer price inflation down to 5% by March 2017. The administration hopes that lower food price pressure will also lead the RBI to loosen monetary policy further (the central bank has cut interest rates by a cumulative 150 basis points since January 2015). The RBI keenly tracks food prices. Owing to rising food prices—which hit a 21 month high—consumer price inflation stood at 5.8% in May. This makes it unlikely that the RBI will cut its main policy interest rate, the repurchase (repo) rate, at its next monetary policy meeting on August 9th.

Impact on the forecast

This development is in line with our expectations. We expect the government to continue to make efforts to curb food price pressure. However, in the light of higher than anticipated food prices, we will raise our forecast for inflation in 2016 at the next forecasting round.

June 17, 2016: External sector

Exports remain mired in contraction

Event

According to data released by the Ministry of Commerce and Industry, merchandise exports fell marginally in May, by 0.8% year on year to US$22.2bn. Imports of goods contracted by a stronger 3.7% to US$28.4bn. The trade deficit stood at US$6.3bn.

Analysis

The decline in imports is attributable mostly to the 30.5% year-on-year plunge in the value of petroleum and crude oil products, resulting from low global commodity prices. Gold imports, which fell by 39.1% on weak demand, also contributed to the decrease in merchandise imports. A recent roll-back of a controversial tax on gold looks set to revive demand for the precious metal in the coming months, probably leading to higher imports.

The decline in merchandise exports, which fell by their slowest pace in 18 months, was mostly the result of base effects. Exports had declined by more than 20% in the previous year and remain (like imports) well below the peaks seen in 2014. The Economist Intelligence Unit expects India's export performance to remain poor in 2016. Year-on-year export growth is likely to swing into positive territory soon, but will remain at depressed levels. On a positive note, the data offered some respite for the manufacturing sector. Exports of engineering goods (which accounted for one-quarter of outbound shipments in May) rose by 2.2%, to reach US$5.8bn.

With both merchandise and services exports subdued, the administration looks unlikely to achieve its trade targets during its term in office, which ends in 2019. In the absence of a major devaluation of the rupee against the US dollar, which is unlikely, a return to the export performance seen in 2013–14 looks unlikely in the medium term. We consequently expect that pressure from businesses for a weaker rupee will continue to build. However, the governor of the Reserve Bank of India (RBI, the central bank), Raghuram Rajan, has repeatedly indicated his opposition to a sharp currency devaluation as a tool to boost exports and economic growth. Thus, the RBI will continue its current policy of reducing exchange-rate volatility.

Impact on the forecast

The data are in line with our view of continued weakness in India's merchandise trade.

June 17, 2016: External sector

Current-account deficit narrows on lower commodity prices

Event

According to data released by the Reserve Bank of India (RBI, the central bank), the current-account deficit stood at US$318m in the first quarter of 2016, or the equivalent of 0.1% of GDP.

Analysis

The development is in line with The Economist Intelligence Unit's view that India is a major beneficiary of relatively low global commodity prices, which remain well below their cyclical peaks recorded in past years. Indeed, India has been able to increase imports of crude oil in volume terms, while lowering them in value terms. This has been a major boon for the government (which has raised taxes on petroleum products) and consumers, who have been able to boost spending. However, as global commodity prices have recovered from the lows recorded in January–March, we expect India's import bill, and therefore its current-account deficit, to expand over the remainder of 2016.

Although the small current-account deficit will be welcomed by currency markets, RBI data also highlight an increasing risk to the outlook for the Indian economy. Exports of services (like merchandise exports) are well below their peaks. Indeed, they fell by 10.9% in January–March compared with the year-earlier period. Among others, this bodes ill for job creation, as many jobs in the services sector are comparatively well paid, providing a source of employment for India's increasingly educated, young workforce.

The decline in services exports is largely the result of stronger competition from countries such as the Philippines, growing labour costs in India for skilled personnel and some international companies deciding to source services from their home markets. The weakness in services is particularly painful for India, where merchandise exports are barely twice as large in value terms as services exports. This marks a huge contrast with China, where merchandise exports are more than seven times higher than services exports. With both Indian manufacturing and services exports struggling, parts of the government's economic agenda are at risk of stalling, despite rosy GDP figures.

Impact on the forecast

We maintain our view that the current-account deficit will average the equivalent of 1% of GDP in 2016. However, we will revise down our forecast for services exports, as we had previously anticipated a modest increase this year.

June 20, 2016: Monetary policy outlook

RBI governor departure setback for macroeconomic confidence

Event

On June 18th the governor of the Reserve Bank of India (RBI, the central bank), Raghuram Rajan, released a statement saying that he would return to academia when his term ends on September 4th.

Analysis

The announcement came as surprise to markets, as it had previously been widely expected that Mr Rajan's three-year term would be extended by two years. The tenures of Mr Rajan's three predecessors had all been extended, and the incumbent RBI governor enjoyed the confidence of financial markets, having lowered inflation expectations successfully and stabilised the Indian rupee since coming into office. However, in the months leading up to the statement, Mr Rajan had come under increased political pressure from parts of the ruling Bharatiya Janata Party and sections of the business establishment.

The government has yet to name a successor to Mr Rajan. However, the risk is that his successor will move away from Mr Rajan's tough inflation-targeting monetary policy stance. As expected, the Indian rupee fell in value against the US dollar on Monday following the announcement. Even though Mr Rajan has cut interest rates by a cumulative 150 basis points since January 2015, he was under pressure to go even further. His successor may be unable to ward off government and business calls for lower interest rates.

Importantly, Mr Rajan's departure also raises questions about the speed and effectiveness of the central bank's effort to reduce non-performing loans in the banking system. By asking banks to fully disclose distressed assets (mostly arising from a spell of lending that went awry under the previous government), Mr Rajan caused much opposition in banking and corporate circles. Banks and some corporates are hoping that Mr Rajan's successor will prove less aggressive in pursuing bad loans. While this would be positive in the short term (freeing up capital and resulting in higher corporate investment), the long-term implications of a failure to carry out a banking clean-up would be negative for the economic growth outlook.

Impact on the forecast

In the light of this development, The Economist Intelligence Unit will adjust upwards its forecast for consumer price inflation in 2017-20. We will also revise our exchange-rate forecast to show a stronger depreciation of the rupee.

June 22, 2016: Policy trends

FDI reform opens up some sectors

Event

On June 20th the government announced that it would liberalise the foreign direct investment (FDI) regime in a number of sectors, including defence, pharmaceuticals, civil aviation and single-brand retailing.

Analysis

The decision removes some bureaucratic obstacles and raises foreign-investor ownership limits in a number of sectors. The move is designed to spur job creation amid much public criticism that economic growth has so far failed to boost employment significantly. The government states that the latest reforms make India "the most open economy in the world for FDI". However, this overstates the case, as a number of bureaucratic restrictions remain in place, impeding the inflow of investment and hampering the ease of conducting business in India for foreigners.

Recently, the defence sector has received much attention, notably under the government's "Make in India" scheme, which aims to bolster manufacturing growth and employment. The sector is set to expand rapidly as the government modernises the armed forces, but data from the Department of Industrial Policy and Promotion shows that since April 2000 foreign investors gave only US$5m to this sector, representing a tiny proportion of total FDI inflows. Although inflows are set to rise from these low levels under the latest reforms, concerns about technology-sharing mean that foreign investors may initially be cautious.

Changes to FDI restrictions in the pharmaceuticals and single-brand retailing industries are welcome, if long overdue, but confusion remains over the exact legal implications. Moreover, an ongoing emphasis on sourcing locally produced goods will continue to impose operational challenges on retailers. Still, the government's message that a liberalised economy benefits India is a long-term positive for the country's outlook, as it chips away at protectionist sentiment, which persists among parts of the electorate and political class.

Impact on the forecast

The Economist Intelligence Unit continues to believe that, owing to its large domestic market and potential, India will attract growing FDI inflows. The latest regulatory changes reinforce this view. However, the operating environment for foreign investors will remain challenging over the forecast period.

June 23, 2016: Monetary policy outlook

Banking sector stress weighs on credit growth

Event

On June 22nd the governor of the Reserve Bank of India (RBI, the central bank), Raghuram Rajan, presented a speech on stress in the domestic banking system.

Analysis

The speech marked a spirited defence of Mr Rajan's track record at the RBI and came shortly after he announced that he would not seek an extension of his term (which ends in September). Mr Rajan was criticised by some Indian corporate leaders and politicians for having caused a private-sector investment slowdown by keeping interests rates too high and neglecting the adverse impact that low wholesale prices have had on the ability of domestic companies to service high debt burdens.

During the speech Mr Rajan reiterated the importance of addressing non-performing loans in sectors such as infrastructure. Reducing stress in bank balance sheets, notably public-sector banks, will also be important. Such an approach contrasts with the views of influential politicians such as Subramanian Swamy who have called for deeper interest rate cuts, even though the key interest rate has already fallen by a cumulative 150 basis points since January 2015.

Mr Rajan rejected the idea, proposed by some government members, of using the RBI's considerable reserves to recapitalise banks. However, this proposition appears to have gained in prominence in recent weeks and could be taken up by his eventual successor. Such a step would reduce the government's fiscal burden and help it to meet the budget deficit target, which has been set at the equivalent of 3.5% of GDP in 2016/17 (April-March). However, RBI funds would be a rather non-transparent means of addressing stress in the banking sector and could also create conflicts of interest for the RBI (as it would both regulate and hold considerable stakes in banks under such a scenario). Such an approach—while helping the government meet its fiscal targets—would also not resolve the medium-term fiscal challenges.

Impact on the forecast

The development has no impact on The Economist Intelligence Unit's forecasts. However, we question whether Mr Rajan's successor will follow a similarly hawkish monetary policy stance.

Analysis

June 15, 2016

EIU global forecast - False dawn for emerging markets

As the second half of 2016 approaches, The Economist Intelligence Unit sees few reasons to expect the global outlook to improve significantly. The ailments that have resulted in a below-par performance in the past 18 months are proving difficult to shift. Low commodity prices continue to hurt the big producers, while demand remains sluggish among consumers in the developed world. Investors' and policymakers' anxiety about the ability of the Chinese government to cool its economy at a steady pace has shifted from acute to chronic, while the much-vaunted turn in the global monetary policy cycle has so far resulted in just a single, 25-basis-point, interest-rate rise in the US, with other advanced economies years away from following suit.

Nonetheless, recent weeks have offered a temporary salve. The dovish outlook of the Federal Reserve (Fed, the US central bank) has stalled the dollar rally, providing relief to emerging-market currencies. Chinese growth has stabilised temporarily, although this is coming at the cost of a further build-up of leverage in the financial system. Oil prices reached an eight-month high in June, of US$50/barrel, but this owed more to supply disruptions than strengthening demand, and we expect them to slip back. First-quarter economic growth in Europe and Japan exceeded expectations, but this pace will not be sustained.

Given the fragile basis for the improvement in sentiment, we expect volatility to be the dominant theme of 2016–17, driven by global monetary policy divergence and concerns that the Chinese government's efforts to stimulate the economy will only worsen the inevitable reckoning in its financial system. The developed world will remain dependent on accommodative central banks, with fears about deflation persisting. The outlook for emerging markets is clouded by weak export demand, policy mismanagement and heightened geopolitical risk.

Overall, we expect global GDP growth to moderate slightly, from 2.4% in 2015 to 2.3% this year. Growth will accelerate to an average of 2.7% in 2017–18 as the outlook for emerging markets gradually improves. The global economy will then slow once more, to 2.2% in 2019, when we expect the end of the US business cycle to result in a mild recession, before recovering to 2.5% in 2020.

Developed world

The developed world will struggle to rouse domestic demand. There is still excess capacity in the US, Europe and Japan, despite years of interest rates at rock-bottom levels. The financial crisis acted as a structural break in the functioning of these economies, but the new rules of the game are still being learned. Trend levels of economic growth, inflation, interest rates and trade are all materially lower than they were before 2008. The primary policy response has been to engage in unprecedented levels of monetary easing. We are pessimistic about the ability of the UK, Europe and Japan to lift their main policy interest rates from rock bottom in our forecast period (2016–20), and we expect the pace of Fed monetary tightening to be pedestrian compared with previous cycles.

Of the four, the US economy is in the best position. We think the business cycle that began with the recovery from the financial crisis still has three years to run. Inflation will accelerate as the labour market tightens, forcing the Fed to continue to push up interest rates. The business cycle will turn in 2019 as higher interest rates curb private consumption, resulting in a short recession. The recovery in 2020 will be relatively brisk as pent-up demand is released.

In Europe, the European Central Bank (ECB) remains firmly in the loosening phase of its cycle. Confidence in the euro zone will be undermined by existential questions about its future, the rise of national opt-outs from regionwide policy and its ability to resolve the migrant crisis. The Greece question also remains unanswered, with a Greek exit from the euro zone at some point in the next five years more likely than not. We forecast that the UK will vote to remain in the EU at a referendum on June 23rd. The adverse impact on the economy of a vote to leave would be severe: we estimate a cumulative loss in output of 6% of GDP by 2020 compared with our non-Brexit baseline forecast.

The fate of Japan is what European governments are keen to avoid. Growth is lacklustre, pulled down by a shrinking workforce, a rising old-age dependency ratio and tight immigration controls. The Bank of Japan (the central bank) is pursuing unconventional measures, most recently a levy on some commercial bank reserves. Another increase in the size of its quantitative easing programme is likely in the next six months, despite no clear evidence of the strategy's efficacy. The government has been forced to delay a planned increase in the consumption tax again, another indication that Abenomics has failed to achieve the desired outcome.

Emerging markets

For most emerging markets the first half of 2016 has been more comfortable than the second half of 2015. Expectations of US monetary tightening have fallen, reducing the threat of emerging-market central banks being forced to raise interest rates before inflationary pressure has built. Instead, consumer price inflation has remained low and interest rates have been widely left on hold, enabling real incomes to rise. Capital flows into emerging markets turned negative in 2015—a remarkable reflection of the lack of confidence in the developing world—but were back in positive territory in March, when net inflows stood at US$37bn, according to estimates from the Institute of International Finance. Finally, a host of emerging-market currencies have made up ground that was lost against the dollar in 2015. At the beginning of June the Indonesian rupiah was up by 5.8% compared with end-2015, the Russian rouble by 12% and the Brazilian Real by 17.4%. Stronger currencies have reduced the cost of imported goods, supporting domestic consumer spending.

This new-found optimism is, for the most part, a false dawn. Our view that 2016–17 will remain a difficult period for emerging markets still holds. We forecast that commodity prices will pick up, but only slowly, and we expect the oil price to dip again in the months ahead before enjoying a more sustained ascent. Interest rates will rise in the US, albeit slowly, supporting the strong US dollar and attracting capital from emerging markets, which will put upward pressure on emerging-market borrowing costs. Terms of trade for most emerging markets will remain weak.

In China the authorities are finding the ongoing process of delivering a consumption- and services-driven economy hard to manage. The economy is growing at two speeds: the manufacturing sector, plagued by overcapacity and inefficiency, is struggling to expand at all, but the consumer-driven services sector is thriving. As the engine of growth shifts from manufacturing to services, further periods of volatility are certain. We put the risk of China experiencing a hard landing at some point in the next five years at 40%. (We define a hard landing as a drop of 2 percentage points or more in average annual economic growth compared with the previous year.) In India lower oil prices have eased structural problems with high inflation. Growth should remain steady, averaging 7.3% a year in 2016–20, but the measures that could see it reach double digits again will prove hard to legislate without an upper-house majority.

The malaise affecting Latin America will continue for a third year in 2016. The underperformance is being driven by Brazil, where GDP is forecast to fall by 3% in 2016. The new president, Michel Temer, has yet to secure approval for any reforms in Congress, but the policy direction appears generally positive. There is a commitment to addressing the fiscal problem, which is crucial given the worsening public–debt ratio. Outside Brazil, even better-performing countries, such as Peru and Colombia, are struggling with a downturn in the credit cycle. Venezuela faces a high risk of default. We assume a political transition that will see the president, Nicolás Maduro, leave office early, probably in 2017. There is likely to be a restructuring of the debts of PDVSA, the state oil company, in 2016.

Cheap oil means that oil producers in the Middle East and North Africa are cutting spending to contain budget deficits while also seeking to diversify economic activity. Saudi Arabia has released a new strategy that aims to end the country's "addiction to oil", although it does not address the kingdom's unpredictable and opaque business climate—arguably the biggest problem facing companies operating in the country. Non-oil economies have received a boost from cheap fuel and, combined with a stronger Iran, will enable regional GDP growth to accelerate from 2% in 2016 to 3.5% a year on average in 2018–20. Sluggish growth in South Africa, Nigeria and Angola will continue to depress Sub-Saharan African growth. At 2%, GDP growth this year will be the slowest pace of expansion since 1993. A less supportive external environment, including generally weak commodity prices, slower growth in China and much-reduced international liquidity amid rising interest rates

in the US, will continue to expose the structural flaws that plague many African economies. Growth will remain below 4% throughout the forecast period.

Exchange rates

Broad moves in the dollar continue to be most strongly influenced by expectations about the rate at which the Fed will proceed with monetary tightening. Having regained its footing for much of May, the dollar came under renewed pressure in early June in response to a weak non-farm payrolls report for May. A rate rise is no longer in prospect for June but is still likely in July, assuming that the labour market rebounds. We expect the broad-based dollar index to stay close to current levels, before a cycle of dollar weakness sets in from 2019, when we expect the US economy to suffer a technical recession.

Commodities

After a dismal start to 2016, oil prices are now experiencing their strongest rally in several years, with dated Brent Blend doubling from a 13-year low of US$26/b in January to over US$52/b in early June. The oil market had been oversold in late 2015 and early 2016, creating the conditions for a rally that has gained added momentum from lower US shale output and supply disruptions in Nigeria and Canada. We expect fewer supply problems in the second half of the year, which will push prices down again, before a more prolonged, fundamental-led rally begins in late 2016. Industrial metals prices will recover slowly in the remainder of the decade. An El Niño phenomenon has put some upward pressure on food prices, but stocks are generally very plentiful.

World economy: Forecast summary

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Real GDP growth (%)										
World (PPP* exchange rates)	3.9	3.3	3.2	3.4	3.1	3.1	3.5	3.5	3.1	3.4
World (market exchange rates)	2.8	2.2	2.2	2.5	2.4	2.3	2.6	2.7	2.2	2.5
US	1.6	2.2	1.5	2.4	2.4	2.0	2.3	2.3	1.0	2.1
Euro area	1.7	-0.8	-0.2	0.9	1.6	1.6	1.6	1.7	1.5	1.6
Europe	2.2	0.1	0.6	1.4	1.6	1.6	1.8	1.9	1.8	1.9
China	9.5	7.7	7.7	7.3	6.9	6.7	6.0	5.0	4.4	4.2
Asia and Australasia	4.2	4.4	4.4	4.0	4.0	4.0	3.9	3.7	3.4	3.3
Latin America	4.7	3.1	2.9	1.3	0.1	-0.2	2.0	2.8	2.9	3.1
Middle East & Africa	3.2	3.8	1.9	2.3	2.2	2.0	2.8	3.6	3.3	3.5
Sub-Saharan Africa	4.6	4.2	4.7	4.4	3.0	2.0	3.2	3.9	3.7	3.6
World inflation (%; av)	**4.9**	**4.0**	**3.9**	**3.6**	**3.3**	**3.9**	**4.0**	**3.7**	**3.0**	**3.1**
World trade growth (%)	**7.1**	**3.4**	**3.8**	**4.0**	**2.8**	**2.9**	**3.5**	**3.6**	**2.7**	**3.3**
Commodities										
Oil (US$/barrel; Brent)	110.9	112.0	108.9	98.9	52.4	42.7	55.5	67.5	62.8	61.8
Industrial raw materials (US$; % change)	21.7	-19.4	-6.8	-5.1	-15.2	-6.8	7.9	6.3	-5.4	-1.9
Food, feedstuffs & beverages (US$; % change)	30.0	-3.5	-7.4	-5.2	-18.7	-4.2	4.3	3.4	-1.1	-0.2
Exchange rates (av)										
¥:US$	79.7	79.8	97.6	105.9	121.0	112.3	112.0	111.0	110.5	109.0
US$:€	1.39	1.29	1.33	1.33	1.11	1.11	1.12	1.12	1.16	1.18

*PPP=purchasing power parity

Source: The Economist Intelligence Unit.

June 21, 2016

Restoring West Bengal to its former glory is tough challenge

With a population of more than 91m, West Bengal is India's fourth most populous state, giving it political importance and, potentially, tremendous economic heft. However, once a key industrial hub, the state underwent a painful process of de-industrialisation in past decades from which it has never fully recovered. Even though economic governance is improving, land and labour laws remain rigid and act as a constraint on growth. Politically, West Bengal is set to remain influential at national level and may hold a deciding role in the fate of the ruling party's reform agenda.

This article forms part of a series on the business environment in India's states. The first examined why a greater focus on states by businesses is necessary, as well as which regions are outpacing others or offering large opportunities. The subsequent articles focused on Gujarat, the NCR, Bihar, Uttar Pradesh, Maharashtra and Rajasthan. The next articles will cover other key states such as Punjab and West Bengal.

India's one-time powerhouse

West Bengal has traditionally played a big role in India's political, social, cultural and economic development. It was the original economic powerhouse and a hotbed of India's independence movement. After Indira Gandhi's emergency rule in 1975-77, the political dominance of the Indian National Congress in West Bengal ended. However, what followed until 2011 were policies that stifled private enterprise, a fondness for the provision of all sorts of public goods as well as state-led economic planning and crippling labour strikes. The politicisation of land allocation in particular became a symbol of this period of relative economic stagnation when India's economy grew faster than West Bengal's. Private companies often either collapsed or relocated to other parts of the country.

Still, during its 34-year-hold on power the Communist Party of India (Marxist) claimed higher wages and greater equality as its achievements. Yet at the same time it also oversaw a wave of de-industrialisation that left the state poorly equipped to adapt to economic changes. As a result of this legacy, West Bengal was slow to benefit from the economic liberalisation of the early 1990s and to a large extent this period explains the state's current economic and social challenges.

A revival in the shadow of a difficult past

Since 2011 the Trinamool Congress, under the leadership of the controversial Mamata Banerjee—she has faced criticism for some of her social and economic policies as well as her style of governance—has ruled the state, and its economy is now transforming. In recent years it has outperformed India's economy in terms of overall growth. Official statistics show that income per head in West Bengal grew at close to double-digit rates in the past three years. Furthermore, a nascent industrial revival has taken hold, and information technology industries are growing rapidly, tapping into the state's well-respected universities. However, outside Kolkata (the state capital) agriculture dominates. In fact, West Bengal is the country's largest producer of rice and fish.

State revenue has doubled in the last four years, allowing the government to expand infrastructure investment. This has enhanced the business environment and attracted private-sector investment. The outcome of the 2016 state election—which renewed Ms Banerjee's grip on power—will also provide West Bengal with some political stability over the coming years.

Still, the political change and reform process that would speed up the reconnection of West Bengal to the world economy is likely to be gradual. The rise of Ms Banerjee and the end to communist rule have not alleviated all challenges. Investors complain that corruption is still widespread, labour laws remain rigid, and that they are unimpressed with politicians' propensity for populism. Indeed, in a

2015 assessment of states' progress on business reform, the Indian Ministry of Commerce classified West Bengal as a state that must speed up its reform efforts if it wants to attract more foreign and domestic capital.

Advanced calculus

Thanks to its large population, the state is enjoying political importance at national level. It has 42 parliamentary constituencies; this is more than any other state except Uttar Pradesh and Maharashtra. However, the real influence of the state can be found in the upper house, where the administration of the ruling Bharatiya Janata Party (BJP) and its allies lack a majority. In the past two years Congress and its supporters have stalled the passage of parts of the government's reform agenda—such as the goods and services tax (GST)—in the upper house thanks to their numerical advantage. However, recent changes in the composition of the upper house have reduced the vote share of Congress.

The government hopes that—if it manages to isolate Congress—by co-operating with regional parties it will be able to pass some of its desired reforms. This provides states such as West Bengal with significant leverage vis-à-vis the administration of the prime minister, Narendra Modi. The national government will seek to co-ordinate on an issue-by-issue basis with Ms Banerjee, raising her profile in the process. She has already voiced her support for the GST, which bolsters the bill's chances of being passed in the medium term. This is in line with The Economist Intelligence Unit's view, as we expect the GST to be passed eventually.

June 23, 2016

Brexit would generate global economic instability

Should the UK vote to leave the EU in a referendum on June 23rd, The Economist Intelligence Unit expects the decision to generate a prolonged period of global uncertainty, with implications for economic growth, monetary policy and financial markets. The greatest impact would clearly be felt in the UK itself— where we expect GDP to be 6% smaller by 2020 than if voters had chosen to remain—with adverse effects also felt in Europe. But the ripple effects would reach around the world, and we would change our forecasts for monetary policy, the oil price and bond yields in response.

Overall, we would cut our forecast for global GDP growth from 2.3% to 2.2% in 2016 (at market exchange rates), and from 2.6% to 2.4% in 2017. This would chop around US$200bn from the size of the global economy over the next 18 months compared with our baseline scenario where the UK remains in the EU (holding our exchange-rate forecasts unchanged). The economic impact of Brexit would, in effect, remove a country the size of Vietnam from the global economy by the end of 2017.

Monetary moves

The initial response to a Leave vote would be seen in currency and bond markets. Sterling would weaken considerably against most major currencies, and the dollar and the yen would appreciate against the euro as investors sought a safe haven isolated from the difficulties in Europe. Risk aversion and a flight to safety would push bond yields down further, below the record lows already seen in mid-2016. Falling yields represent a nudge to governments that conditions are favourable to borrow cheaply to boost economic growth. However, we do not expect rich-world governments to change the tune that they have been doggedly playing for years: a focus on controlling debt and insisting that monetary policy takes the strain of providing support for the economy.

Policymakers in the US and Japan would not welcome currency appreciation. They are trying to create inflationary pressure and generate export demand, and favour cheaper currencies to achieve this. In Japan, a renewed appreciation in the yen—which recently hit a two-year high against the US dollar—would lead to more

unorthodox monetary policy from the Bank of Japan (BOJ, the central bank). Another increase in the size of the BOJ's monthly asset purchases would be likely, and it might also push the interest rate on some commercial bank deposits that it holds further into negative territory. We would trim our forecast for Japanese economic growth in 2016 and 2017.

Kick them when they're down

The Federal Reserve (Fed, the US central bank) would alter its path of interest-rate rises in the event of a Brexit. We currently expect that the Fed will lift its policy rate twice in 2016. Brexit would rule out an increase in July, meaning that, at most, one increase would be possible. If the global economic malaise proved stubborn to shift, any rise in 2016 would be taken off the table too.

The immediate aftermath of Brexit would see conditions resembling the chaotic start to 2016, when stockmarkets around the world plunged in response to fears of a US recession and concerns that the Chinese government had lost control of its economy. Falling stockmarkets would damage economic sentiment, and businesses and consumers would postpone investments and purchases. This happened after the market crash in the first quarter of 2016, when US economic growth was a miserly 0.8% at an annual rate and many emerging markets were soft as well. The months following the Brexit referendum would look similar, but anxiety would be amplified even further.

We would revise down our forecast for economic growth in the euro zone in 2016–17 by around 0.2 percentage points each year; and a similar cut to the US economy would also be in prospect. Although the US is geographically and financially distant from events in the UK, US growth has been fragile of late and is vulnerable to even minor external shocks.

Sentiment over fundamentals

Greater uncertainty in the global economy would translate into weaker commodity prices. The recent upward trend in oil prices would reverse, with the price of crude falling quickly back below US$40/barrel on weaker sentiment. Once the initial shock of Brexit had worn off, we would expect fundamentals gradually to reassert their influence over the oil market, with prices rising again as demand and supply come closer to balance. However, the pace at which prices rise would be slower than in our baseline scenario, reflecting a more tentative global economy.

Watch out for second-round shocks

Emerging markets would also feel the chill of Brexit, but largely through second-round effects. The UK is not a sufficiently big market for emerging markets to be hit badly through weaker trade flows with the UK, but they would experience the impact of investors' diminished risk appetite. Many emerging-market currencies would depreciate, increasing the cost of servicing debts denominated in US dollars. There might also be less investor demand for emerging-market bond issuance, posing problems for countries that depend on external financing. If there were to be a prolonged developed-world slump, foreign direct investment inflows from the UK, Europe and the US could also have a modest negative impact.

It is not all bad news, though. Global conditions could prove favourable for major emerging-market commodity importers such as India and Turkey. Lower energy costs would exert a disinflationary effect, helping central banks to keep monetary policy looser for longer and supporting economic growth. But these effects could be outweighed by anxiety-driven declines in stockmarkets or fears that Europe is heading for the next chapter in its interminable rolling crisis. When an event promises to strip 6% of GDP from the fifth-biggest economy in the world, it is hard to find reasons for the rest of the global economy to be cheerful. Brexit would not plunge the world into recession, but it would ensure another disappointing year for the global economy, which has underperformed far too often.

June 24, 2016

Global economy will suffer fallout from Brexit vote

On June 23rd the UK voted to leave the EU in a referendum. The global economy has already been shaken by a decision that took many investors by surprise. Stock and bond markets around the world plummeted on June 24th and sterling fell to its lowest level against the US dollar for more than 30 years. The Economist Intelligence Unit expects the gyrations in financial markets to continue for weeks. The effects on the real economy will be less pronounced, but lower consumer and business sentiment and deferred investment will still drag global growth down.

Our response to Brexit is to trim our forecast for global GDP growth from 2.3% to 2.2% in 2016 (at market exchange rates), and from 2.6% to 2.4% in 2017. We also expect marginally slower growth in 2018–20. The most profound effects will be felt in the UK, where we expect a recession to take hold in 2017, and then among key trading partners in Europe. But a pervading "risk-off" mood, combined with weaker sentiment and lower investment, will ensure lower growth in the US, Japan and a host of emerging markets.

Monetary moves

The initial response to a Leave vote was seen almost instantly in currency and bond markets. Sterling weakened considerably against most major currencies, the yen rose above the ¥100:US$1 threshold and the dollar appreciated against the euro. We expect the yen and the dollar to remain strong as attractive safe havens for investors. Bond yields have fallen further, and we expect them to decline below the record lows already seen in mid–2016. (The German ten-year bond yield has already fallen to a new low of –0.17%.) Falling yields represent a nudge to governments that conditions are favourable to borrow cheaply to boost economic growth. However, we do not expect rich-world governments to change the tune that they have been doggedly playing for years: a focus on controlling debt and insisting that monetary policy takes the strain of providing support for the economy.

Currency appreciation is unwelcome news for policymakers in the US and Japan. They are trying to create inflationary pressure and generate export demand, and cheaper currencies would help them to achieve this. In Japan we expect further quantitative easing from the Bank of Japan (BOJ, the central bank). Another increase in the size of the BOJ's monthly asset purchases is likely, and it may also push the interest rate on some commercial bank deposits that it holds further into negative territory. We have trimmed our Japan growth forecast, and we now expect growth to average 0.3% a year in 2016–17, from 0.5% a year previously. We are also forecasting a stronger yen in 2016, at ¥109.3:US$1, from ¥112:US$1. We think that the yen will gain further ground, strengthening to ¥103.6:US$1 in 2017.

Kick them when they're down

The Federal Reserve (Fed, the US central bank) will alter its path of interest-rate rises. We now believe that the Fed will be forced to hold its policy rate at the current level until 2017 as uncertainty in global markets feeds through into the US. It will only add 50 basis points that year. This will give the Fed less ammunition than it can deploy in the event of an end to the current US business cycle. We still do not expect this to occur until 2019, but the risk of it occurring sooner has risen.

We expect the coming weeks to see similar conditions to the chaotic start to 2016, when stockmarkets around the world plunged in response to fears of a US recession and concerns that the Chinese government had lost control of its economy. Falling stockmarkets will damage economic sentiment, and businesses and consumers will postpone investments and purchases. This happened after the market crash in the first quarter of 2016, when US economic growth was a miserly 0.8% at an annual rate and many emerging markets were soft as well. Policymakers will look to calm

financial markets in the short term, but given the political changes necessary in the UK before Brexit can begin to be implemented, a prolonged period of high anxiety is likely.

We have revised down our forecast for economic growth in the euro zone in 2016–17 by 0.2 percentage points in each year. This ensures that the region will continue to expand at only moderate rates, despite the support provided by extraordinarily loose monetary policy. We have also cut our US growth forecast, to 1.8% in 2016 (from 2%) and to 2.2% in 2017 (from 2.3%). Although the US is geographically and financially distant from events in the UK, US growth has been fragile of late and is vulnerable to even minor external shocks.

Sentiment over fundamentals

Greater uncertainty in the global economy will also translate into weaker commodity prices. The recent upward trend in oil prices will reverse, with the price of crude falling back below US$40/barrel on weaker sentiment. (We were already expecting a fall in oil prices in the third quarter of 2016, as we believe that the oil market is still carrying a weighty surplus.) In 2017 we expect the market to continue to move towards balance, but the pace at which prices rise will be slower than in our previous scenario, reflecting a more tentative global economy.

Watch out for second-round shocks

Emerging markets will also feel the chill of Brexit, but largely through second-round effects. The UK is not a sufficiently big market for emerging markets to be hit badly through weaker trade flows with the UK, but they will experience the impact of investors' diminished risk appetite. Many emerging-market currencies will depreciate against the dollar and the yen, increasing the cost of servicing debts denominated in these currencies. There may also be less investor demand for emerging-market bond issuance, posing problems for countries that depend on external financing. If there were to be a prolonged developed-world slump—which is not our central forecast—lower foreign direct investment inflows from the UK, Europe and the US could also have a modest negative impact.

If any economies can be optimistic, it is major emerging-market commodity importers such as India and Turkey. Lower energy costs will exert a disinflationary effect, helping central banks to keep monetary policy looser for longer and supporting economic growth. But these effects could be outweighed by anxiety-driven declines in stockmarkets or fears that Europe is heading for the next chapter in its interminable rolling crisis. When an event promises to strip 6% of GDP from the fifth-biggest economy in the world, it is harder for the rest of the global economy to grow as quickly. Brexit will not plunge the world into recession, but it will ensure that the global economy continues to underperform its potential for at least another two years.

World economy: Forecast summary

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Real GDP growth (%)										
World (PPP* exchange rates)	3.9	3.3	3.2	3.4	3.1	3.0	3.3	3.4	3.1	3.3
World (market exchange rates)	2.8	2.2	2.2	2.5	2.4	2.2	2.4	2.6	2.1	2.5
US	1.6	2.2	1.5	2.4	2.4	1.8	2.2	2.3	1.0	2.1
Euro area	1.7	-0.8	-0.3	1.0	1.6	1.6	1.3	1.5	1.3	1.4
Europe	2.2	0.1	0.6	1.5	1.6	1.6	1.2	1.6	1.4	1.7
China	9.5	7.7	7.7	7.3	6.9	6.7	6.0	5.0	4.4	4.2
Asia and Australasia	4.2	4.4	4.4	4.0	4.0	3.9	3.8	3.6	3.4	3.3
Latin America	4.7	3.1	2.9	1.3	0.1	-0.2	1.9	2.8	2.9	3.1
Middle East & Africa	3.2	3.8	1.9	2.3	2.2	1.9	2.8	3.6	3.3	3.5

Sub-Saharan Africa	4.6	4.2	4.7	4.4	3.0	1.9	3.2	3.9	3.3	3.2
World inflation (%; av)	**4.9**	**4.0**	**3.9**	**3.6**	**3.3**	**3.9**	**4.1**	**3.8**	**3.1**	**3.1**
World trade growth (%)	**7.1**	**3.4**	**3.8**	**4.0**	**2.7**	**2.9**	**3.6**	**3.7**	**2.8**	**3.3**
Commodities										
Oil (US$/barrel; Brent)	110.9	112.0	108.9	98.9	52.4	40.3	52.5	65	62.4	61.4
Industrial raw materials (US$; % change)	21.7	-19.4	-6.8	-5.1	-15.2	-6.8	7.9	6.3	-5.4	-1.9
Food, feedstuffs & beverages (US$; % change)	30.0	-3.5	-7.4	-5.2	-18.7	-4.2	4.3	3.6	-1.1	-0.4
Exchange rates (av)										
¥:US$	79.7	79.8	97.6	105.9	121.0	109.3	103.6	107.0	109.0	109.0
US$:€	1.39	1.29	1.33	1.33	1.11	1.08	1.07	1.12	1.13	1.15

*PPP=purchasing power parity

Source: The Economist Intelligence Unit.

