

**ECONOMIC AND
MARKET ANALYSIS:
INDIA**

Economics

12 July 2005

Rohini Malkani
+9122-5631-9876
rohini.malkani@citigroup.com
Mumbai

Anushka Shah
Mumbai

India Macroscope

Medical Tourism in India: A New and Growing Opportunity

- **India's healthcare industry looks poised for rapid growth due to favorable demographics, a changing disease profile, and rising incomes and education levels**
- **The availability of low-cost, high-quality medical care is rapidly turning India into a 'global health care destination'**
- **Besides the macro benefits from medical tourism (as a result of higher forex earnings), an array of services and industries benefit**
- **Given the continuation of key growth drivers, we maintain our 7.5% GDP estimate for FY06**

Contents

Investment Summary	3
Statistical Snapshot	4
Theme: Medical Tourism in India — A New & Growing Opportunity	5
Changing external sector drivers.....	5
Medical tourism: Another new opportunity for the external sector	5
The healthcare revolution in India	6
Emerging opportunities.....	7
Real Indicators	8
Monsoons monitor	9
Monetary Indicators	10
Fiscal Indicators	12
External Sector	14
Financial Markets	16
Forex markets	16
Bond and derivatives markets	17
Policy Watch	18
The India–Singapore Treaty	18
Monthly Macro Monitor	19
Summary of Balance of Payments	20
Snapshot of Government Finances	21
Global Economic Forecasts	22
Global Financial Market Forecasts	23

Our theme this month analyzes the opportunities arising from India's burgeoning private healthcare industry. Besides the macro benefits of medical tourism, an array of services and industries benefit — all of which appear positive for growth.

Medical tourism in India: A new and growing opportunity

India's healthcare industry looks poised for rapid growth due to favorable demographics, a changing disease profile, and rising incomes and education levels. While India's public healthcare system leaves a lot to be desired, the country's burgeoning private healthcare industry has made rapid progress. The availability of low-cost, high-quality medical care is rapidly turning India into a 'global health care destination'. Major corporations such as the Tatas, Fortis, Max, Wockhardt, Piramal, and the Escorts Group have made significant investment in setting up state-of-the-art hospitals in the major Indian cities, with some of them designing special packages for international patients, including airport pickups, visa assistance, and board and lodging.

Emerging opportunities in the healthcare sector

Besides the macro benefits of higher revenue earnings for India's external account, the key beneficiaries of medical tourism and the healthcare boom are the service providers (hospitals — in all three verticals of healthcare), infrastructure providers (medical and service equipment), and materials providers (medicines and disposables). Preventive healthcare and healthcare insurance companies should also benefit.

Growth: We maintain our FY06 GDP estimate of 7.5%

The Central Statistical Organization's recently released 4Q FY05 GDP estimate contained no surprises, with the economy registering 7% growth in 4Q, with full-year FY05 growth estimated at 6.9%. We are maintaining our 7.5% FY06 GDP estimate, and we reiterate that, while the agri outcome will depend on the monsoons, given the continuation of the key growth drivers, non-farm growth is likely to trend close to 9%.

External sector: Current account deficit likely to widen further

After three years of running a current account surplus, India's current account returned to the red in FY05. We expect the deficit to widen further from US\$6.4bn in FY05 to US\$12bn in FY06 due to the widening of the trade deficit — a result of higher oil, non-oil, and defense imports. The key point to note is that growth in exports and invisibles remains buoyant, while capital flows are more than sufficient to finance the current account deficit, and the net accretion to reserves is likely to be at least US\$14bn.

Financial markets: Liquidity is key

While movements in the rupee are unlikely to be uni-directional, given the outlook for capital inflows, we maintain our 12-month view of the rupee touching Rs42.5/US\$1. Softer near-term inflation could result in lower gilt yields in the near term; long term, we maintain our 12-month view of the 10-year touching 7.5%.

Statistical Snapshot

Figure 1. India — Macroeconomic Summary, FY97-07E

Year to 31 Mar	FY97	FY98	FY99	FY00	FY01	FY02	FY03	FY04	FY05	FY06E	FY07E
National Income Indicators											
Nominal GDP (Rs Bils.)	12,435	15,224	17,409	19,369	20,899	22,821	24,633	27,600	31,055	34,471	38,263
Nominal GDP (US\$ Bils.)	350	409	413	446	457	475	510	601	690	792	911
Per Capita GDP (US\$)	367	422	418	448	454	468	497	583	669	757	857
Real GDP Growth (%)	7.5	5.0	6.5	6.0	4.4	5.8	4.0	8.5	6.9	7.5	7.4
Agriculture Growth (%)	9.6	-1.9	7.1	0.5	-1.4	6.8	-7.2	9.6	1.1	3.0	3.0
Industry Growth (%)	6.0	5.8	3.4	5.3	6.5	3.3	6.8	6.6	7.7	8.0	8.3
Services Growth (%)	7.2	9.0	8.1	9.7	6.2	6.6	7.9	9.1	8.9	9.0	8.6
Real indicators (% YoY)											
Cement Dispatches	8.3	10.6	6.4	14.1	0.1	8.6	11.1	6.5	6.8	8.8	8.7
Commercial Vehicle Sales	9.4	-33.2	-11.2	22.0	-11.9	-4.5	27.9	38.1	24.0	10.0	10.0
Car Sales	14.5	1.5	-0.9	54.9	-6.9	4.5	7.6	32.8	18.7	13.0	11.0
Two-Wheelers	11.5	2.7	11.7	9.4	0.7	15.3	17.0	11.4	16.8	15.0	12.0
Diesel Consumption	8.4	3.5	3.7	5.5	2.0	-3.5	3.0	4.5	7.4	6.0	6.5
Tele-Density	1.5	1.9	2.2	2.8	3.5	4.3	5.2	6.6	8.4	10.3	10.3
Monetary Indicators											
Money Supply	16.2	18.0	19.4	14.6	16.8	14.1	14.7	16.6	14.0	14.0	14.0
Int rate PLR – Year-End	14.5	13.0	12.0	11.3	11.5	11.3	10.8	10.3	10.0	9.8	9.5
Inflation – WPI	4.6	4.4	5.9	3.3	7.2	3.5	3.4	5.4	6.5	5	4.5
CPI	9.4	6.8	13.1	3.4	3.8	4.3	4.0	4.0	4.5	4.0	4.0
Bank Credit Growth	9.6	16.4	13.8	18.2	17.3	15.3	23.7	15.3	23.0	20.0	20.0
Deposit Growth	16.6	18.4	19.3	13.9	18.4	14.6	16.1	17.5	14.2	14.2	14.2
Fiscal Indicators (% to GDP)											
Center's Fiscal Deficit	4.6	4.8	5.1	5.4	5.7	6.2	5.9	4.5	4.5	4.3	4.0
State Fiscal Deficit	2.7	2.9	4.2	4.9	3.9	3.9	4.6	4.1	3.6	4.0	4.0
Combined Deficit (Center+State)	6.4	7.3	9.0	9.6	9.2	9.6	9.9	9.3	9.0	9.0	9.0
Combined Domestic Liabilities	52.6	54.9	56.2	59.2	66.4	71.4	75.9	77.0	77.9	77.9	
Combined O/S Guarantees	9.7	9.7	9.9	11.2	12.2	11.4	11.2	12.0	12.0	12.0	
External Sector											
Exports (US\$ Bils.)	34.1	35.7	34.3	37.5	45.5	44.7	53.8	64.7	80.8	100.2	122.3
% YoY	5.6	4.5	-3.9	9.5	21.1	-1.6	20.3	20.4	24.9	24.0	22.0
Imports (US\$ Bils.)	48.9	51.2	47.5	55.4	57.9	56.3	64.5	80.2	119.0	147.5	168.2
% YoY	12.1	4.6	-7.1	16.5	4.6	-2.8	14.5	24.4	48.4	24.0	14.0
Trade Balance (US\$ Bils.)	-14.8	-15.5	-13.2	-17.8	-12.5	-11.6	-10.7	-15.5	-38.1	-47.3	-45.9
Invisibles (US\$ Bils.)	10.2	10.0	9.2	13.7	9.8	15.0	17.0	26.0	31.7	35.3	37.7
Current Account Balance (US\$ Bils.)	-4.6	-5.5	-4.0	-4.1	-2.7	3.4	6.3	10.6	-6.4	-12.0	-8.2
% of GDP	-1.3	-1.3	-1.0	-0.9	-0.6	0.7	1.2	1.8	-0.9	-1.5	-0.9
Forex Reserves (Excl Gold) (US\$ Bils.)	22.4	26.0	29.5	35.1	39.6	51.0	71.9	107.4	135.2	149.2	169.6
Months of Imports	5.5	6.1	7.5	7.6	8.2	10.9	13.4	16.1	13.6	12.1	12.1
Exchange Rate											
Rs/US\$ - Annual Avg	35.5	37.2	42.2	43.4	45.7	48.0	48.3	45.9	45.0	43.5	42.0
% Depreciation	6.3	4.8	13.4	2.8	5.3	5.0	0.6	-5.0	-2.0	-3.3	-3.4
Rs/US\$ - Year-End	35.8	39.52	42.4	43.6	46.5	48.9	47.5	43.6	43.5	42.5	42.0
% Depreciation	4.7	10.4	7.3	2.8	6.7	5.2	-2.9	-8.2	-0.2	-2.3	-1.2

Source: CSO, RBI, Ministry of Finance, Citigroup estimates.

Theme: Medical Tourism in India — A New & Growing Opportunity

- The healthcare industry in India looks poised for rapid growth due to favorable demographics, a changing disease profile, and rising incomes and education levels
- While its public healthcare system leaves a lot to be desired, the country's burgeoning private healthcare has made rapid progress
- The availability of low-cost, high-quality medical care is rapidly turning India into a 'global health care destination'
- However, substantial investment is needed to realize the benefits of this growing opportunity

Changing external sector drivers

The key drivers of India's external sector have changed over the past decade. From purely traditional exports to the software story (classified under invisibles in the balance of payments) in the mid-1990s, India is now considered a manufacturing base for exports of automobiles, auto components, and engineering and capital goods. The possibility of higher textile exports post the quota removal earlier this year and higher pharma exports, along with the rise in remittances, all add up in offsetting the burgeoning trade deficit. Medical tourism is also a new rapidly growing segment.

Medical tourism: Another new opportunity for the external sector

The availability of low-cost, high-quality medical care is rapidly turning India into a 'global health destination'. Statistics suggest that the medical tourism industry in India is worth US\$333m, with a study by CII-McKinsey estimating additional revenues at US\$2bn by 2012. Recently, India has seen a surge of patients from developed countries, as well as from countries that lack adequate healthcare infrastructure (e.g., from African and Asian countries). Key factors contributing to the surge in medical tourism include:

- **Cost efficiencies.** Medical services are cost-competitive in India, even compared with those of other developing nations, such as the Philippines and Thailand.

Figure 2. India's Cost Advantage — A Comparative View of Surgery Costs (US\$)

Surgery	Thailand	India
Bone marrow transplant	62,500	30,000
Liver transplant	75,000	40,000
Open Heart Surgery	14,250	4,400
Hip Replacement	6,900	4,500
Knee Surgery	7,000	4,500
Hysterectomy	2,012	511
Gall Bladder Removal	1,755	555

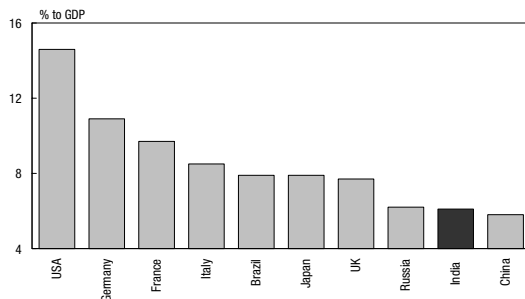
Source: IBEF.

- **High quality.** With growing privatization and improved technology, India's medical services are on par with international standards, particularly in the areas of cardiology, cosmetic and orthopedic surgery, dentistry, eye-care, and preventative health checks. Apart from these, ayurvedic, alternative, and holistic healthcare alternatives have long been India's forte. Major corporations such as the Tatas, Fortis, Max, Wockhardt, Piramal, and the Escorts Group have made significant investment in setting up state-of-the-art hospitals in the major Indian cities, with some of them designing special packages for international patients, including airport pickups, visa assistance, and board and lodging.
- **Policy initiatives.** To its credit, the government has introduced various policy measures to further encourage the surge in medical tourism. For instance, the National Health Policy recognizes the treatment of international patients as an export, which implies that private hospitals treating international patients can enjoy benefits such as lower import duties, an increase in the rate of depreciation from 25% to 40% for life-saving medical equipment, and other tax sops.

The healthcare revolution in India

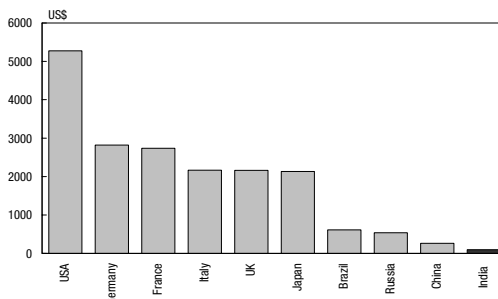
The healthcare industry in India looks poised for rapid growth, with the key drivers so far being favorable demographics¹ and a changing disease profile². However, with rising disposable incomes and education levels, increasing healthcare expectations, and the growing role of the private sector, the industry appears to have significant growth potential. As the charts below show, public expenditure on health in India is modest as a percentage of GDP compared with that in the developing world and per capita health expenditure is weak.

Figure 3. Total Health Expenditure as a percentage of GDP



Source: World Health Statistics, 2005.

Figure 4. Per Capita Expenditure on Health (US\$)



Source: World Health Statistics, 2005.

¹ With an improvement in life-expectancy levels, the proportion of the population in the 15-54 (working age group) and the 55+ age groups has been rising. The 55+ age group, which currently comprises 11% of the population, is the age group that is likely to be a consumer for healthcare delivery.

² With changing lifestyle patterns, there has been a shift in disease profiles from infectious diseases (such as meningitis, tuberculosis, and hepatitis) to lifestyle-related diseases – such as cardiovascular disorders and diabetes.

Key features of the Indian healthcare market

- ▶ **Private-sector domination.** A quick look at the structure of the Indian healthcare industry reveals that the private sector plays a major role in service delivery, comprising roughly 80% of the total healthcare market of Rs1,090bn. This is because public-sector healthcare infrastructure, with the exception of a few recognized centers of excellence, has a reputation for inefficiency, poorly maintained equipment, and long waiting lists.
- ▶ **Inadequate infrastructure.** The medical infrastructure in India includes more than 600,000 physicians, 15,533 hospitals, and more than 700,000 hospital beds. However, on a comparative basis, these statistics trail those of other developing countries. For instance, the number of beds per thousand population in India is very low, at 0.9 — much lower than China's 2.5 beds and Brazil's 2.7. India also has a low density of doctors. Although India trains a large number of medical staff, the numbers produced have barely kept pace with population growth.
- ▶ **Government incentives.** Over the past few years, the government has taken major steps to increase health spending. The National Health Policy, 2002, aims to improve health standards across the country through the prevention and control of communicable diseases. It addresses all aspects of healthcare (such as education, infrastructure, and financial resources). Other government incentives include:
 - 1 **The National Rural Health Mission,** launched in April this year, which aims to strengthen primary healthcare for the rural population, with a special focus on 18 states that have particularly weak health indicators.
 - 2 **Boosting the competitiveness of the Indian pharmaceutical industry.** Under the new patent regime, the government has set up an R&D corpus fund for the industry worth Rs1.5bn, with a plan to increase it in phases.
 - 3 **Other fiscal incentives.** Rehabilitation aids have been fully exempt from customs and excise duties since FY04. Since FY04, the government has also conferred infrastructure status on the healthcare industry, which allows private hospitals to raise cheaper long-term capital.

Emerging opportunities

The key beneficiaries of the healthcare boom have been service providers (hospitals — in all three verticals of healthcare), infrastructure providers (medical and service equipment), and materials providers (medicines and disposables). Other beneficiaries include:

Preventive healthcare companies: Growing health consciousness among middle- and high-income families in India has resulted in a new business opportunity of preventive healthcare, with the addressable population for preventive health checks close to 160m.

Health insurance: Although the government and major corporates provide some form of health protection, just around 10% of the population is covered by this, and most health spending in India is 'out of pocket'. However, with the insurance sector opened to the private sector in 2000, increasing affordability, rising income levels, and rising demand for better quality healthcare, spending looks set to rise.

Real Indicators

- GDP numbers for 4Q FY05 contained no surprises, with the economy registering 7% growth in the quarter, and full-year FY05 growth of 6.9%
- We are maintaining our FY06 GDP estimate of 7.5% and we reiterate that, while the agri outcome will depend on the monsoons, given the continuation of the key growth drivers, non-farm growth is likely to trend close to 9%

No surprises in 4Q FY05 GDP

GDP rose 7% in 4Q FY05, in line with expectations, led by services (+9.3%) and industry (+6.7%), while agriculture was up just 1.8%, due largely to a fall in food grain production. Thus, full-year FY05 growth came in at 6.9% yoy, which is unchanged from the Central Statistical Organization’s advanced estimates, released in February 2005.

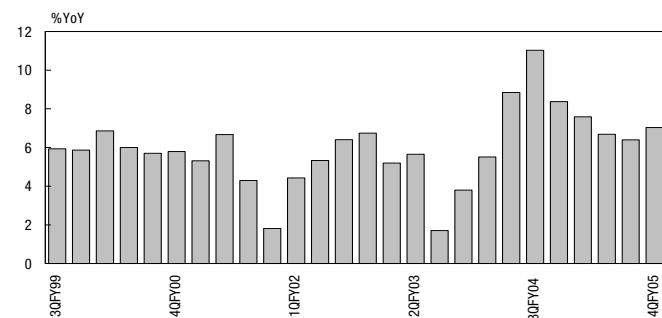
Key data highlights include: (1) the continuation of buoyant trends in manufacturing (up 8.6%); and (2) robust growth in services (up 9.3%), led mainly by double-digit growth in trade, hotels and communications (up 11.1%). This is particularly encouraging, with the 11.1% growth coming off a high base of 14.6%.

Figure 5. Quarterly Trends in GDP and Full-Year Estimates (% YoY)

	Weights	FY04	FY05				FY04	FY05	FY06E
		Q4	Q1	Q2	Q3	Q4			
Agriculture	22.0	10.4	3.8	0.0	-0.5	1.8	9.6	1.1	3.0
Industry	27.2	7.7	7.1	8.2	8.8	6.7	6.6	7.7	8.0
Manufacturing	17.2	7.6	7.9	9.6	10.5	8.6	6.9	9.2	9.1
Mining	2.4	10.7	6.9	4.7	4.5	2.5	6.4	4.5	5.4
Electricity	2.4	7.6	6.1	9.1	4.4	2.6	3.7	5.5	5.0
Construction	5.3	6.6	5.0	4.6	7.2	4.1	7.0	5.2	6.7
Services	50.8	8.0	9.5	8.1	8.9	9.3	9.1	8.9	9.0
Trade, hotels, communication	24.1	14.6	11.5	12.3	10.8	11.1	11.8	11.4	11.4
Financing, insurance	13.0	7.6	7.0	5.5	8.2	7.7	7.1	7.1	7.2
Community services	13.7	-2.9	8.2	3.0	5.6	7.2	5.8	5.9	6.0
GDP at factor cost	100.0	8.4	7.6	6.7	6.4	7.0	8.5	6.9	7.5

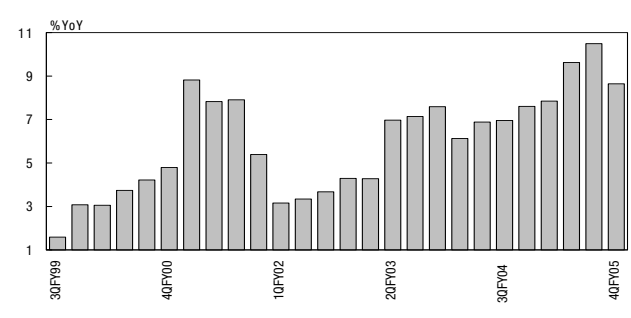
Source: CSO, Citigroup estimates.

Figure 6. QFY05 GDP Growth Pegged at 7%



Source: CSO, Citigroup.

Figure 7. Manufacturing Trends Remain Robust



Source: CSO, Citigroup.

Monsoons monitor

Initial trends not so good...

After a late start and poor progress during the first two weeks of June, the monsoons gathered momentum over the third week of June. The Indian Meteorological Department reported a rainfall deficiency over the first three weeks of June at 49%³, down from 60% for the first two weeks. As regards the distribution of rainfall, data released by the IMD appears discouraging, with scanty/deficient or no rainfall in 19 of the 36 meteorological sub-divisions, and normal/excess rainfall in just 17.

...July is a crucial month for sowing crops

However, distribution and timing of rainfall are perhaps more important than the quantum. Moreover, July is a crucial month for sowing, and, thus, despite deficient rains in the first three weeks of June, we are maintaining our FY06 GDP estimate of 7.5%, assuming a long-term trend of 3% for agriculture.

Figure 8. Monsoon Watch — Distribution of Rainfall Over Sub-Divisions

No of Sub-Divisions with rainfall	Cumulative for the period from 1 June to:					
	28-Jun-00	27-Jun-01	26-Jun-02	02-July-03	30-Jun-04	29-Jun-05
Excess	14	20	14	10	9	3
Normal	13	10	13	20	19	14
Total	27	30	27	30	28	17
Deficient	7	6	8	5	8	17
Scanty	2	0	1	1	0	2
No rain	0	0	0	0	0	0
Total	9	6	9	6	8	19
Total Subdivisions	36	36	36	36	36	36

Source: IMD.

Non-farm growth is more important

Given the erratic nature of agricultural growth and its dependence on the monsoons, we reiterate focusing on non-farm growth is more important. With the continuation of non-farm growth drivers — the unfolding capex story, coupled with strong trends in consumption, due to favorable demographics and rising income levels — we believe that, in the long run, non-farm growth will likely trend toward 9%.

Figure 9. Trends in GDP — With Sensitivity of Agriculture to Growth in FY06E

	Weights	FY04	FY05	FY06E		
				Base Case	El Nino	Good Monsoon
Agriculture	21.5	9.6	1.1	3.0	0.0	6.0
Industry	27.3	6.6	7.7	8.0	8.0	8.0
Services	51.2	9.1	8.9	9.0	9.0	9.0
Overall GDP	100.0	8.5	6.9	7.5	7.1	8.2

Source: CSO, Citigroup estimates.

³ As per its latest press release, the IMD has said that overall rainfall deficiency has now fallen from 49% on 22 June to 15% as on 30 June 2005.

Monetary Indicators

- ▶ **Bank credit continues to drive economic momentum; deposits have picked up, albeit not much, so banks have been drawing down on their investments in GOI securities**
- ▶ **Due to the base effect, inflation has fallen nearly 100bps to 4.1% currently. The recent oil price hike should result in a 34bp rise in inflation**

Banking trends: Buoyancy continues

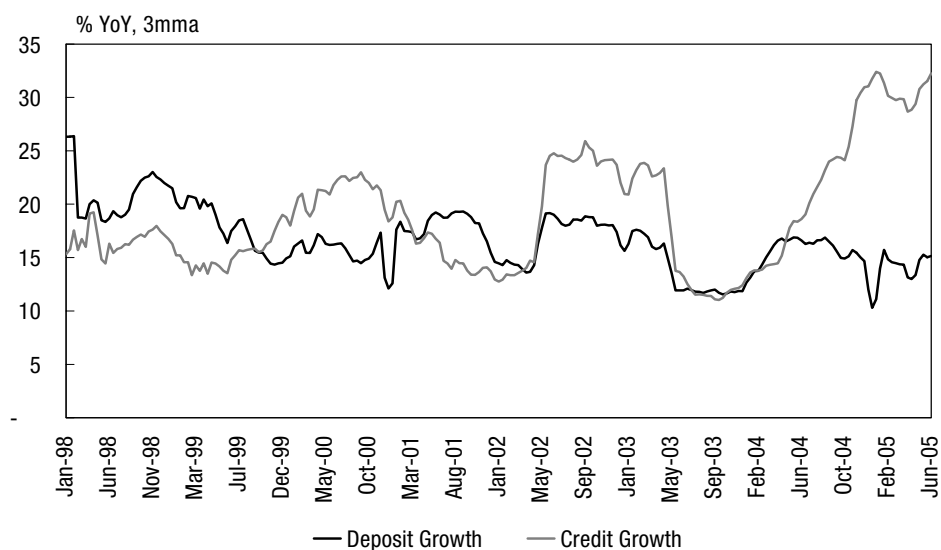
Banking trends remain positive, with incremental credit from 1 April-10 June up Rs581bn, or +32.5% yoy. Encouragingly, deposit growth has seen a pickup this year, with incremental deposits during 1 April-10 June up Rs660bn, or 14.8% yoy. However, with the credit deposit ratio touching 64.4% (an all-time high), banks have been drawing down on their investments. Investments in government securities have fallen by Rs61bn fiscal YTD, compared with a rise of Rs400bn last year.

Figure 10. Trends in Bank Credit & Deposits (Rupees in Billions, % YoY)

	Outstanding March 05	Incremental to date		YoY%	Total			
		FY06	FY05		FY05	FY04	FY03	FY02
Bank Credit								
Food	360	46	72	6.0	46	-129	-46	140
Non-Food	8,048	535	200	33.9	2308	1278	1086	643
Total Bank Credit	8,408	581	272	32.5	2354	1149	1041	783
Bonds & Debentures	807	3	-34	1.2	-24	9	61	34
Deposits	15,423	660	438	14.8	1469	1887	1610	1407
GOI Investments	6,759	-61	400	2.0	707	1,248	1,093	681

Source: RBI.

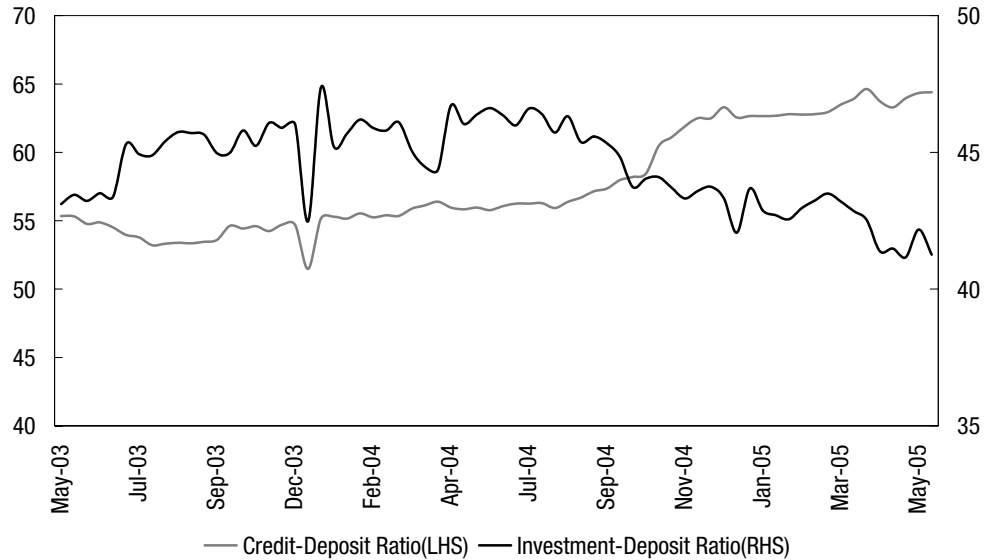
Figure 11. Trends in Deposit and Credit Growth (% YoY)



Source: RBI.

With the credit deposit ratio touching 64.4% (an all-time high), banks have been drawing down on their investments. Investment in government securities has fallen by Rs61bn fiscal YTD, compared with a rise of Rs400bn last year

Figure 12. Trends in Investment and Credit Deposit Ratios (%)

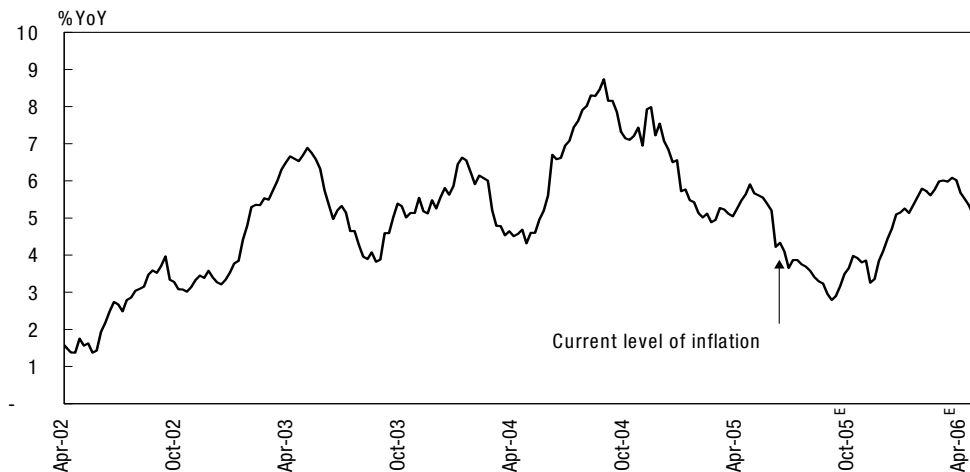


Source: RBI.

Oil price hike should have a marginal impact on inflation

Last month, the government implemented long-overdue⁴ hikes in the prices of petrol and diesel by Rs2.50 and Rs2 per liter, respectively. However, oil companies were lobbying for a Rs5 increase to enable them earn a reasonable return on their auto-fuel businesses. The hike in prices will impact inflation, as petrol and diesel have a 2.9% weighting in the WPI basket. Thus, the direct impact of the 6% hike would result in inflation rising 17bps, with an indirect impact of another 17bps. However, given that the base effect for inflation data would be very supportive in the coming months, headline inflation is likely to remain benign in the coming weeks.

Figure 13. Likely Trends in Inflation (YoY%)



Source: Office of the Economic Advisor.

⁴ Despite oil prices touching record highs, domestic fuel prices had remained unchanged since November 2004, due to political compulsions, resulting in the oil marketing companies (IOC, BPCL and HPCL) bearing losses on the auto-fuel business. Oil companies were lobbying for a hike of Rs4.7 and Rs5.1 per liter for petrol and diesel.

Fiscal Indicators

- **FY05's final fiscal deficit pegged at 4.1% of GDP, compared with the 4.5% estimated earlier this year. This would make the mandated FRBM⁵ targets even more challenging than before**
- **April-May FY06's deficit was 31.5% of the Budget estimate. This is similar to past trends, and a result of the fact that, while expenditures occur throughout the year, revenues pick up later in the year**

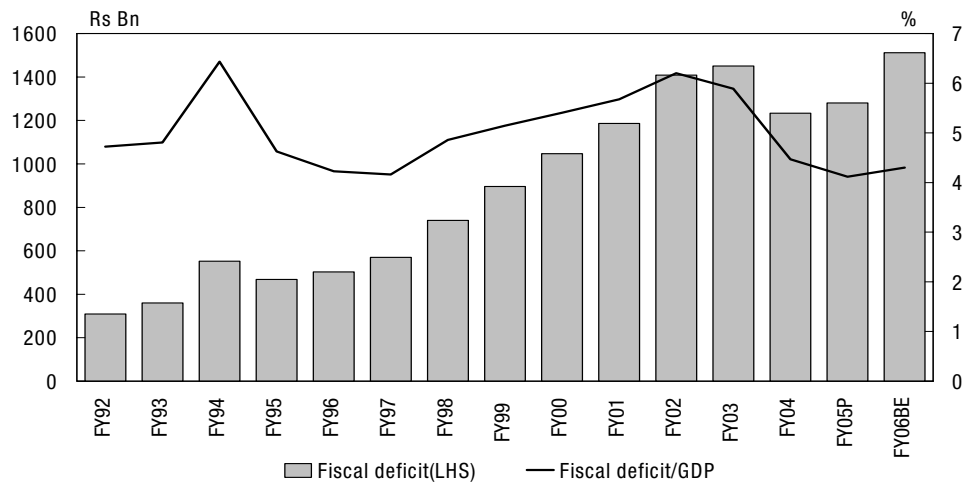
Lower-than-expected FY05 fiscal deficit...

Final fiscal deficit numbers peg the FY05 fiscal deficit at Rs1,280bn. This is Rs112bn lower than the revised estimate of Rs1,392bn released at the time of the presentation of the Budget in February this year, and has been attributed to expenditure curtailments and an increase in non-tax revenues. This brings the fiscal deficit down to 4.1% of GDP; lower than the estimated target of 4.5% and, as a percentage of GDP, this is its lowest level since 1996.

... but reducing the deficit further will be a challenge

The FY06 Budget set a fiscal deficit target of 4.3% for FY06, resulting in the finance minister saying that FRBM targets would have to be 'paused'. The reason being, as per the revised fiscal deficit of 4.5% of GDP for FY05, the proposed deficit reduction for FY06 was just 20bps — and not 30bps as stipulated by the FRBM. However, with the latest data (FY05 deficit at 4.1%), the FY06 target of 4.3% is 20bps higher than the FY05 deficit, and, thus, if efforts are not made to raise revenues or reduce expenditure, FRBM targets would be regressive.

Figure 14. Fiscal Deficit as a Percentage of GDP in FY05 was at a Seven-Year Low of 4.1%



Source: Budget Documents.

⁵ Under the Fiscal Responsibility and Budget Management Act (FRBM), the center's revenue and fiscal deficit must be reduced by 0.5% and 0.3% per annum, respectively, so that the revenue deficit is eliminated by 2009 and the fiscal deficit reduced to 3% by 2008.

April-May fiscal deficit Rs476bn, 31.5% of Budget estimate

Data released recently by the Controller General of Accounts peg India's fiscal deficit for the period April–May 2005 at Rs476bn, up 22.1% yoy and 31.5% of the Budget estimate.

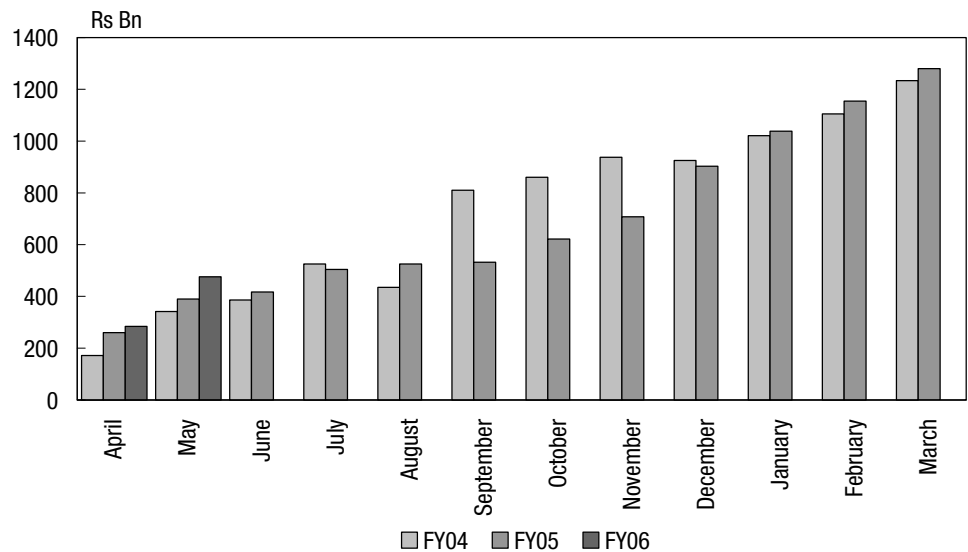
During April-May, total receipts reached Rs121bn (3.3% of estimates), while expenditure (at Rs597bn) was 11.6% of estimates. This is similar to past trends, and a result of the fact that, while expenditures occur throughout the year, revenues pick up later in the year.

Figure 15. April-May 2005 Fiscal Data

Rs bn	May-05	YoY%	Apr-May 2005	YoY%	FY06BE	YTD of Bud. (%)
a. Revenue receipts	102	44.3	119	51.0	3,512	3.4
Net tax revenues	91	51.0	87	83.5	2,735	3.2
Non-tax	12	7.5	33	3.0	777	4.2
b. Non-debt cap receipts	0.6	-99.4	2	-98.6	120	1.6
c. Total receipts (a+b)	103	-39.9	121	-43.3	3,632	3.3
d. Revenue expenditure	274	-0.2	561	6.4	4,465	12.6
e. Capital expenditure	21	-5.6	36	6.6	678	5.4
f. Total expenditure (d+e)	295	-2.0	597	-1.0	5,143	11.6
g. Fiscal deficit (f-c)	192	47.9	476	22.1	1,511	31.5
Revenue deficit (d-a)	171	-16.8	442	0.8	953	46.3

Source: Controller General of Accounts, Budget Documents.

Figure 16. Monthly Trends in the Fiscal Deficit (Rupees in Billions)



Source: Controller General of Accounts.

External Sector

- After three years of running a current surplus, India’s current account fell back into the red in FY05
- We expect this trend to continue, but it is due to the widening of the trade deficit — as a result of higher oil, non-oil and defense imports
- The key point to note is that growth in exports and invisibles remains buoyant, while capital flows are more than sufficient to finance the current account deficit, and the net accretion to reserves is likely to be at least US\$14bn

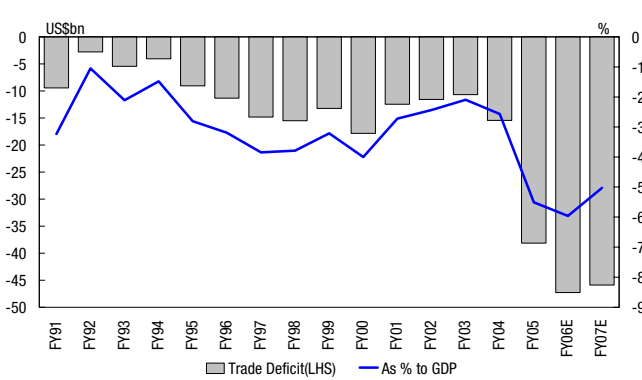
4Q FY05 BOP: US\$12.6bn accretion to reserves

After two quarters of running a current account deficit, a record rise in invisible earnings (software + remittances) offset the widening trade deficit, resulting in the 4Q FY05 current account going back to a surplus. Robust capital flows, led by higher overseas borrowings and foreign investment, were the key factors that enabled a US\$12.6bn accretion to reserves.

Current account: Back to a deficit in FY05

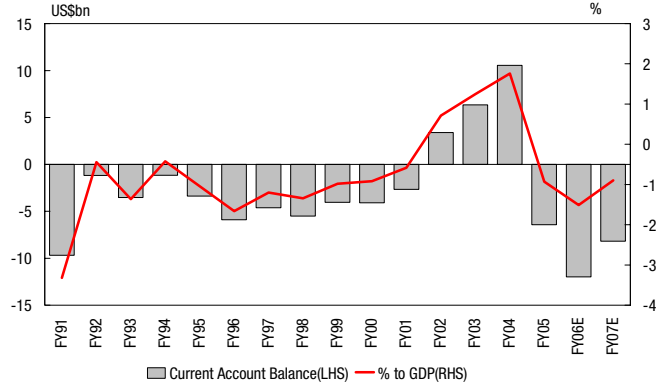
After three years of running a current surplus, the current account for full-year FY05 returned to the red. While invisibles remained buoyant (increasing from US\$26bn in FY04 to US\$31.7bn in FY05), the sharp rise in the trade deficit from US\$15.5bn in FY04 to US\$38.1bn in FY05 resulted in the current account posting a deficit of US\$6.4bn in FY05, compared with a surplus of US\$10.6bn in FY04. However, inflows on the capital account remained buoyant at US\$26.2bn.

Figure 17. Trade Deficit Touches an All-Time High



Source: RBI; Citigroup estimates.

Figure 18. Resulting in a Return to a Current Account Deficit



Source: RBI; Citigroup estimates.

FY06E outlook: US\$14bn BOP surplus likely, despite current account deficit

While export growth is likely to remain buoyant, due to better prospects in textiles, auto and auto-components, pharmaceuticals and engineering goods, we expect trade deficit to widen further to US\$47.3bn, due to higher imports (oil, non-oil and possibly airplanes).

This would likely result in the current deficit widening to US\$12bn (1.5% of GDP); however, the outlook for capital flows remains positive, which is likely to result in a minimum accretion of US\$14bn to reserves.

Four reasons why we remain positive on the external sector

Even though the current account deficit is likely to widen to US\$12bn in FY06E (compared with US\$6.4bn in FY05), we maintain our positive stance on the external sector and our 12-month rupee view of Rs42.5/US\$1, due to:

- 1 20%-plus export growth for three consecutive years;
- 2 Higher imports being a result of oil prices touching record highs, an increase in non-oil imports — which is supportive of the ongoing momentum in the economy — and a bunching up of defense imports;
- 3 Buoyant capital flows — even after excluding so called ‘hot-money’ (FII + NRI deposits), flows are more than sufficient to finance the current account deficit; and
- 4 Forex reserves of US\$139bn, which are sufficient to finance more than 14 months of imports.

Figure 19. India's Balance of Payments (US\$bn)

US\$bn	FY04	FY05				FY04	FY05	FY06E
	Q4	Q1	Q2	Q3	Q4			
1. Current Account (a+b)	5.8	3.4	-4.5	-5.5	0.2	10.6	-6.4	-12.0
Exports	20.3	17.8	18.9	20.9	23.2	64.7	80.8	100.2
Imports	21.8	23.0	28.5	32.7	34.8	80.2	119.0	147.5
a. Trade Balance	-1.5	-5.2	-9.6	-11.8	-11.5	-15.5	-38.1	-47.3
b. Invisibles	7.2	8.6	5.1	6.3	11.7	26.0	31.7	35.3
2. Capital Account (c:g)	4.0	4.5	3.7	11.7	12.4	20.5	32.2	26.0
c. Loans	0.0	2.9	1.4	3.2	4.2	-2.8	11.7	7.5
d. Foreign Investment	4.7	0.8	1.5	5.3	4.4	14.8	11.9	12.0
e. Banking Capital Net	0.4	1.8	-0.3	-0.4	2.9	6.2	4.0	4.0
f. Other capital	-1.0	-0.7	1.1	3.7	0.9	2.8	5.0	3.0
g. Rupee debt service	-0.1	-0.3	0.0	0.0	-0.1	-0.4	-0.4	-0.5
Errors & Omissions	0.3	-0.3	0.2	0.4	0.1	0.3	0.4	0.0
Overall Balance (1+2)	10.1	7.6	-0.6	6.6	12.6	31.4	26.2	14.0

Source: RBI; Citigroup estimates.

Financial Markets

- While movements in the rupee are unlikely to be uni-directional, given the outlook for capital inflows, we maintain our 12-month view of the rupee touching 42.5/US\$1
- Softer near-term inflation could result in lower near-term gilt yields; long term, we maintain our 12-month view of the 10-year touching 7.5%

Forex markets

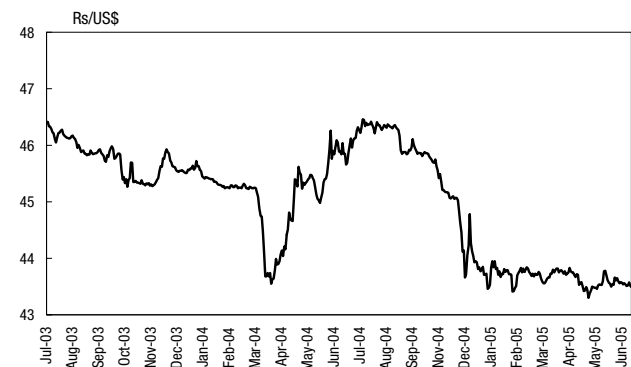
- The rupee rose 0.6% to 43.52/US\$1 in early July, from the 43.77/US\$1 levels recorded during late May. This was due mainly to a revival of FII flows, which crossed US\$1bn in June (compared with negative flows during the first few months of this fiscal). While the rupee broke the 43.50 barrier on several occasions, it failed to sustain its gains due to the dollar’s broad rallies and crude oil prices touching historical highs.
- The six-month premium rose to 1.48% (compared with 0.9% in May), due mainly to the cash-dollar shortage. An improvement in dollar liquidity in June induced an upward correction in the premium, which remained range-bound around 1.35% before edging up under pressure due to higher crude oil prices.

Figure 20. India — Rupee Forecasts and Forwards

	Range in May	Spot 29 June	One Month		Three Months		Six Months		12 Months	
			Forecast	Forward	Forecast	Forward	Forecast	Forward	Forecast	Forward
Versus US\$										
India INR	43.265-43.7	43.53	43.50	43.69	43.50	43.82	43.00	43.97	42.50	44.19

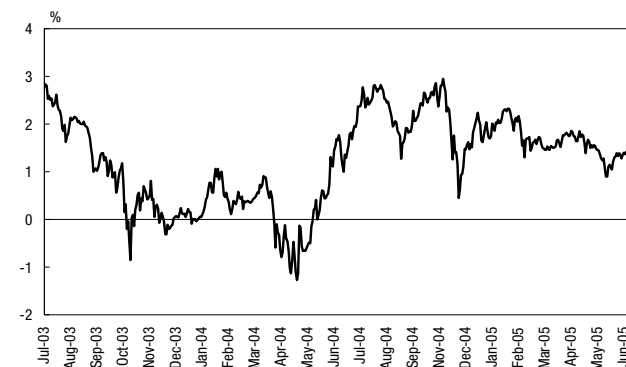
Source: RBI, Citigroup estimates.

Figure 21. Rupee Trends (Rs/US\$)



Source: RBI.

Figure 22. Trends in Six-Month Forward Premiums (Percent)



Source: RBI.

Bond and derivatives markets

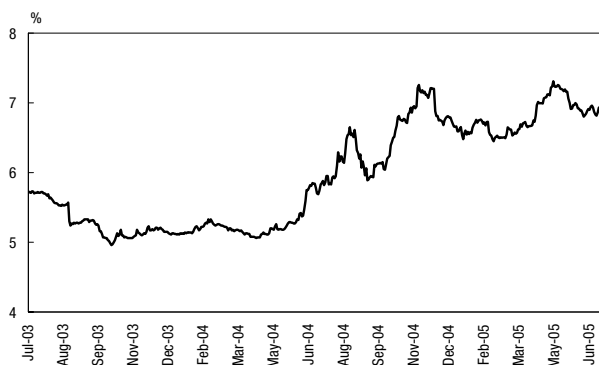
- The 10-year benchmark yield fell marginally from 6.98% in late May to 6.9% by end-June due to change in sentiment in the interest-rate market. However, yields were fairly volatile and trading interest was unevenly distributed across segments. The 10-year yield fell to 6.8%, with high crude prices and concerns over liquidity preventing a further drop in yields. The hike in petrol/diesel prices did not hurt market sentiment, as the market believed that there would not be further hikes in the immediate future.
- The AAA five-year yield eased from 7.2% in late May to 7.1% in late June, tracking the general direction of debt-market yields. Lower inflation and the rally in US treasuries lifted market sentiment and activity. However, trading interest tapered off due to the tightening of liquidity. The credit spread of the five-year benchmark segment rose from 30bps in late May to 36bps by the end of June, as non-SLR bonds were unable to keep pace with the drop in risk-free yields.
- Reverse repo bids at the RBI LAF window fell from Rs229bn in May to Rs40bn toward the end of June. This was due mainly to market borrowings, poor inflows and advance tax payments. However, yields remained benign as the government's surplus cash with the RBI was close to Rs200bn.

Figure 23. India — Interest Rate Monitor

	Latest	Previous	1M Ago	3M Ago	12M Ago
Interest Rates (%)					
Overnight	5.90	5.00	5.10	5.50	4.25
1 year Treasury Bill	5.63	5.60	5.59	5.66	4.65
1 year OIS	5.49	5.46	5.50	5.45	5.03
1 year MIFOR	5.32	5.21	4.88	5.27	4.08
5 year Corp AAA spread ov GOI	0.37	0.39	0.38	0.65	0.96
10 year GOI	6.96	6.86	6.92	6.73	5.78

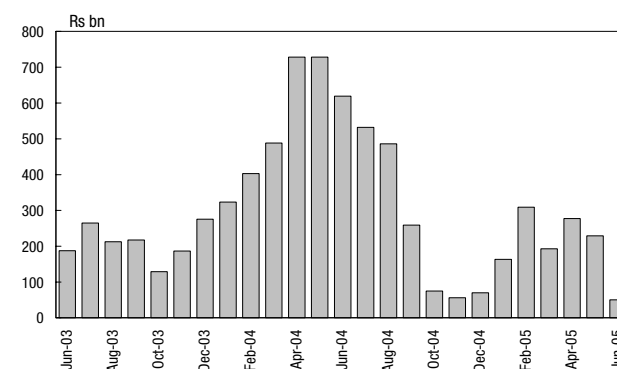
Source: Citigroup, RBI.

Figure 24. India — Trends in the 10-Year GOI Bond (Percent)



Source: RBI.

Figure 25. India — Trends in Reverse Repos (Rupees in Billions)



Source: RBI.

Policy Watch

The India–Singapore Treaty

Late last month, the Indian Prime Minister, Dr. Manmohan Singh, and the visiting prime minister of Singapore, Mr. Lee Hsien Loong, signed a Comprehensive Economic Cooperation Agreement (CECA) between the two countries. The CECA, which will come into effect from 1 August 2005, is likely to further boost trade and capital flows. The CECA extends beyond free trade and includes trade in services, and agreements on investments, technology, education, and taxation.

- **Trade in goods:** This involves duty-free exports to Singapore for a substantial chunk of goods. India will also cut tariffs on imports from Singapore to zero over a five-year period, with customs duties on 506 trade items scrapped immediately. The agreement involves eliminating duties on over 2,202 items, and reducing duties on 2,407 items in a phased manner by 2009.
- **Investment:** India has agreed to grant Singaporean firms pre-established national treatment in 22 industries, including manufacture of motor vehicles, textiles, development of townships, and housing and construction projects. Singapore's list includes all manufacturing sectors, apart from beer, cigars, and other demerit goods.
- **Capital gains concessions:** Under the Double Taxation Avoidance Agreement, capital gains concessions accorded to Mauritius have been extended to Singapore. Consequently, capital gains earned by Singaporean residents on the sale of shares would be liable to tax only in Singapore. This would be a major benefit for Indian software firms operating in Singapore.
- **Financial services:** Under the CECA, three Singaporean banks – the Development Bank of Singapore, Overseas Chinese Banking Corporation and the United Overseas Bank – will be given national treatment on par with Indian banks regarding branches, places of operation and prudential requirements. In turn, Indian banks already operating in Singapore will get full banking status, which means they will be allowed to process electronic fund transfers and use local ATMs.
- **Other services:** Temasek Holdings and Government of Singapore will be allowed to own as much as 20% of local companies as per CECA. SEBI had earlier put a cap of 10% of investment by FIIs. A key component of services also refers to the movement of people; it will now be easier for more than 120 categories of professions to get a visa, due to the easing of visa restrictions.

How will India benefit?

Besides the potential increase in bilateral trade (trade between the countries is US\$6.4bn currently), the India-Singapore pact should aid commerce, investment, infrastructure development, and financial markets. Industries that should benefit include air transport, banking, and the IT sector. Moreover, with safeguards neatly in place to make sure that Rules of Origin⁶ are strictly followed, third-country products should not come into India via Singapore.

⁶ Rules of Origin (ROO) are included in FTAs to specify when a good will be regarded as a product within the FTA, so as to cross between member countries without incurring a tariff. For the India-Singapore pact the three ROO criteria are: (a) value addition of

Monthly Macro Monitor

Figure 26. India — Key Monthly Economic Indicators (Percentage Change from a Year Ago Unless Stated Otherwise)

Monthly Macro Snapshot	FY04		FY05											FY06	
	Mar 04	Apr 04	May 04	Jun 04	Jul 04	Aug 04	Sep 04	Oct 04	Nov 04	Dec 04	Jan 05	Feb 05	Mar05	Apr 05	May-05
Consumption Trends															
Two-Wheelers	33.4	17.5	5.9	14.2	21.4	13.9	13.4	8.7	23.5	39.9	17.7	13.9	16.1	23.9	22.7
Passenger Car Sales	18.9	28.5	17.3	21.4	18.3	28.7	24.2	37.0	19.6	21.0	6.6	0.4	12.3	12.6	9.6
Commercial Vehicle Sales	42.6	68.5	41.0	27.8	17.8	19.5	20.1	22.9	22.6	24.8	21.8	15.7	17.0	-11.9	4.8
Investment Trends															
Infrastructure Index	7.2	9.2	5.2	3.1	7.6	4.4	5.9	4.6	5.0	3.6	1.9	-0.6	3.7	3.6	5.6
Cement Dispatches	5.0	15.9	-4.0	-2.2	9.4	0.3	11.8	17.3	10.0	8.9	10.4	0.9	7.3	9.3	13.5
Diesel Consumption	14.1	26.0	13.6	-0.5	10.8	-11.0	15.4	10.2	-11.9	-0.6	9.1	-0.1	4.7	-5.2	
Steel Production	6.9	-0.3	5.6	3.3	3.5	4.1	4.1	8.1	13.9	10.1	2.9	2.6	7.1		
Aluminum Production	5.1	-0.3	0.8	2.6	11.1	0.8	13.4	-5.5	14.5	12.8	23.1	4.2	11.8	5.9	
Ind. Production Index															
General	8.1	8.9	6.8	7.3	8.5	8.6	9.8	10.6	7.7	8.9	7.5	5.1	8.8	8.8	
Manufacturing	8.1	8.8	7.5	8.1	8.4	9.1	10.5	11.9	8.6	9.8	8.6	6.5	9.6	10.0	
Basic Goods	6.4	8.0	3.0	2.9	5.7	5.2	8.3	7.4	6.6	6.6	4.9	1.0	7.1	5.9	
Capital Goods	25.2	10.1	13.0	16.9	11.6	13.5	16.8	13.2	7.8	19.7	8.2	6.4	20.3	24.5	
Intermediate Goods	5.3	12.4	13.0	7.4	6.4	4.9	3.8	7.9	3.7	3.4	1.6	2.2	5.1	2.3	
Consumer Goods	6.3	6.5	3.9	9.1	12.7	14.4	14.9	15.9	12.6	12.3	15.2	11.3	9.2	13.1	
Services															
Port Traffic	17.9	5.6	10.1	6.7	12.3	15.9	7.2	15.6	14.4	9.6	8.1	11.2	16.7	15.5	
Railway Freight	9.0	5.9	6.6	6.0	9.2	4.0	9.9	12.2	5.1	9.8	9.2	5.3	10.7	15.5	
Tourist Arrivals ('000)	272.8	218.8	189.0	206.1	274.2	259.0	235.0	319.3	364.6	394.2	363.6	372.2	341.6	250.6	223.2
Cellular Subscribers (Mils.)	26.6	27.2	28.2	29.2	30.6	32.0	33.6	34.8	35.9	37.4	38.6	39.8	41.0	42.1	43.3
Banking Trends															
Money Supply	15.3	15.7	15.6	15.0	15.4	15.6	14.2	14.2	13.8	13.4	13.7	13.1	12.1	13.4	13.8
Loan Growth	14.5	17.8	18.3	19.4	21.6	24.0	24.4	27.3	30.8	31.8	31.4	29.8	28.7	30.8	32.1
Deposit Growth	16.7	16.3	16.6	16.8	16.8	16.5	15.0	15.7	14.6	10.3	15.7	14.5	13.1	14.8	15.1
Non-Food Credit	19.6	20.9	20.6	22.0	23.1	20.8	27.3	30.5	32.1	33.3	32.8	32.3	33.7	32.9	33.3
Inflation															
CPI (IW)	3.5	2.2	2.8	3.0	3.2	4.6	4.8	4.6	4.2	3.8	4.4	4.2	4.2	5.0	3.7
WPI	4.8	4.5	5.0	6.7	7.6	8.5	7.8	7.2	7.6	6.7	5.5	5.0	5.2	5.6	5.4
Mfg Products Inflation	6.6	5.9	5.0	6.3	6.8	6.8	7.1	7.0	6.2	6.0	5.3	4.5	4.6	5.3	5.5
Interest Rates (Avg, %)															
Call Money Rate	4.3	4.2	4.2	4.2	4.2	4.3	4.3	4.5	5.5	5.1	4.7	4.8	4.1	4.9	5.1
91-Day T-Bills	4.3	4.4	4.4	4.5	4.5	4.8	4.8	5.2	5.5	5.3	5.3	5.2	5.3	5.2	5.2
10-Year Government Bond	5.2	5.1	5.2	5.5	5.9	6.4	6.1	6.7	7.1	6.7	6.6	6.5	6.6	7.0	7.1
PLR (Maximum)	11.0	11.0	11.0	11.0	11.0	11.0	10.8	10.8	10.8	10.8	10.8	10.8	10.8	10.8	10.8
Trade - Customs Data															
Exports	52.6	34.2	32.4	47.8	18.8	28.1	17.4	9.4	25.1	14.6	33.2	8.0	8.3	17.2	22.3
Imports	36.4	23.5	32.8	54.3	31.6	25.6	41.2	19.5	43.1	28.7	40.4	39.0	25.5	51.1	35.5
Oil	-16.2	50.9	39.9	39.5	114.1	24.8	71.5	47.4	54.2	-17.3	-5.2	87.6	14.0	41.4	30.6
Non-Oil	57.2	6.9	30.5	59.6	1.0	25.8	30.1	9.8	38.7	44.9	60.0	22.5	29.7	55.9	34.4
Brent Prices (\$/bbl)	33.8	33.3	37.6	35.2	38.3	43.0	43.3	49.8	43.1	39.6	44.4	45.5	53.1	51.3	48.0
Foreign Investment (US\$ Mils.)															
FII	1,834	881	-322	-477	-432	448	414	807	3,032	751	101	1,910	1,716	-149.5	-261.3
FDI	168	217	217	380	173	601	282	214	186	316	152	238	275		
Exchange Rate and Reserves															
US\$ Exchange Rate Average	44.4	44.0	45.2	45.5	46.0	46.3	46.1	45.8	45.1	44.0	43.7	43.7	43.7	43.7	43.5
US\$ Exchange Rate Mnth End	43.6	44.3	45.5	46.0	46.5	46.3	45.9	45.4	44.6	43.5	43.7	43.7	43.7	43.5	43.8
Forex Res Excl. Gold (US\$ Bils.)	106.1	113.0	114.3	114.1	113.0	112.1	113.3	115.6	121.2	125.2	123.7	129.8	135.5	135.9	133.9

Source: CSO, CMIE, RBI, DGCIS&S, CMA, SIAM.

40% in Singapore; (b) a change in the tariff heading of imported raw materials; and (c) specification of the precise nature of the value addition involved.

Summary of Balance of Payments

Figure 27. India's Balance of Payments (US Dollars in Millions, Percent)

HIGHLIGHTS	Year to 31 March	FY01	FY02	FY03	FY04	FY05	FY06E	FY07E
	Current account							
	Exports	45,452	44,703	53,774	64,723	80,831	100,230	122,281
<i>Exports: +20% growth expected to continue</i>	Y/Y %	21.1	-1.6	20.3	20.4	24.9	24.0	22.0
	% of GDP	9.9	9.4	10.5	10.8	11.7	12.6	13.4
	Imports	57,912	56,277	64,464	80,177	118,961	147,512	168,163
<i>Imports: Defense – a big component in FY05</i>	Y/Y %	4.6	-2.8	14.5	24.4	48.4	24.0	14.0
	% of GDP	12.7	11.8	12.6	13.3	17.2	18.6	18.4
<i>Deficit: Likely to widen further due to higher non-oil imports (supporting the growth story)</i>	a. Trade balance	-12,460	-11,574	-10,690	-15,454	-38,130	-47,281	-45,882
	% of GDP	-2.7	-2.4	-2.1	-2.6	-5.5	-6.0	-5.0
	b. Invisibles	9,794	14,974	17,035	26,015	31,699	35,300	37,700
	Non-factor services	1,692	3,324	3,643	6,591	14,630	17,000	19,000
	Investment income	-5,004	-4,206	-3,446	-3,972	-3,979	-4,000	-4,100
	Remittances	12,854	15,398	16,387	22,833	20,459	22,000	22,500
<i>Current account likely to remain in the red...</i>	Official transfers	252	458	451	563	589	300	300
	1. Current a/c balance (a+b)	-2,666	3,400	6,345	10,561	-6,431	-11,981	-8,182
<i>...Capital flows are more than sufficient to finance current account deficit</i>	% of GDP	-0.6	0.7	1.2	1.8	-0.9	-1.5	-0.9
	Capital Account							
	c. Loans*	5,264	-1,261	-3,850	-2,848	11,661	7,500	5,500
	External assistance	410	1,117	-3,128	-2,742	1,922	500	500
<i>Higher recourse to ECBs and short-term credit due to narrowing of spreads in emerging markets</i>	Commercial borrowings*	4,303	-1,585	-1,692	-1,526	5,947	4,500	3,000
	Short-term credit	551	-793	970	1,420	3,792	2,500	2,000
	d. FDI (Net = a-b)	3,272	4,734	3,217	3,420	3,037	4,500	5,000
	(a) FDI - To India	4,029	6,125	5,036	4,674	5,526	5,500	6,500
	(b) FDI - Abroad	-757	-1,391	-1,819	-1,254	-2,489	-1,000	-1,500
<i>Foreign investment – Will the India-Singapore pact help?</i>	e. Portfolio investment	2,590	1,952	944	11,356	8,907	7,500	8,500
	f. Banking Capital	-1,961	2,864	10,425	6,231	4,002	4,000	5,000
	Commercial Banks (Net)	-4,277	110	7,447	2,589	5,069	2,500	2,500
	NRI deposits	2,316	2,754	2,978	3,642	-1,067	1,500	2,500
	g. Rupee debt service	-617	-519	-474	-376	-417	-500	-500
	h. Other capital**	292	781	578	2,759	4,985	3,000	3,000
	2.Capital a/c (c+d+e+f+g+h)	8,840	8,551	10,840	20,542	32,175	26,000	28,600
<i>Overall balance of payments likely to remain positive</i>	Errors & Omissions	-305	-194	-200	318	415	0	0
	Overall balance (1+2)	5,869	11,757	16,985	31,421	26,159	14,019	20,418
	Forex							
	Forex assets	39.6	51.0	71.9	107.4	135.2	149.2	169.6
	FCA to months of imports (Rhs)	8.2	10.9	13.4	16.1	13.6	12.1	12.1
	Exchange rate							
<i>Rupee: Movement unlikely to be uni-directional, but likely to appreciate over the long term</i>	Rs/US\$ - annual avg	45.7	48.0	48.3	45.9	45.0	43.5	42.0
	% Depreciation	5.3	5.0	0.6	-5.0	-2.0	-3.3	-3.4
	Rs/US\$ - year end	46.5	48.9	47.5	43.6	43.8	42.5	42.0
	% Depreciation/(-) appreciation	6.7	5.2	-2.9	-8.2	0.3	-2.9	-1.2

* Includes US\$4.1bn of the Resurgent Bond Issue repaid in September 2003 and likely repayment of India Millennium Bonds in FY06.

** Includes delayed export receipts, advance payments against imports.

Source: RBI, Citigroup estimates.

Snapshot of Government Finances

Figure 28. India's Central Government Finances (Rupees in Billions, Percent to GDP)

BUDGET 2005-06- KEY MEASURES		Year to 31 Mar	FY01	FY02	FY03	FY04	FY05P	FY06BE
Revenue								
a. Gross Tax Revenue			1,886	1,871	2,163	2,543	3,052	3,700
<i>Corporate taxes reduced to 30%</i>	Corporation Tax		357	366	462	636	830	1,106
<i>Income tax slabs restructured</i>	Income Tax		318	320	369	414	509	662
	Excise Duty		685	726	823	908	1,007	1,215
<i>Excise further rationalized</i>	Import Duty		475	403	449	486	563	532
	Other Tax Revenues		51	56	61	100	151	185
	b. (-) Development to States & UTs		517	528	577	674	802	966
<i>Peak customs duties cut to 15%</i>	c. Net Tax Revenues (a-b)		1,369	1,342	1,585	1,870	2,249	2,735
	d. Non Tax Revenues		559	678	723	769	803	777
	e. Net Revenue Receipts (c+d)		1,929	2,011	2,308	2,639	3,052	3,512
<i>No debt swap this year</i>	f. Non-Debt Capital Receipts		142	200	373	842	653	120
	Recovery of Loans		120	164	342	673	616	120
<i>Divestments – Kept out of the Budget numbers</i>	Of which Debt Swap Proceeds		0	0	138	462	437	0
	Privatization		21	36	32	170	41	0
	g. TOTAL REVENUES (e+f)		2,070	2,211	2,682	3,481	3,705	3,632
Expenditure								
h. Revenue Expenditure			2,779	3,015	3,387	3,621	3,847	4,465
<i>Revenue expenditure is higher, due to:</i>	Interest (1)		993	1,075	1,178	1,246	1,295	1,339
	Defense		372	381	407	431	435	486
<i>(1) The twelfth FC decision on higher grants to states; and</i>	Subsidies		268	312	435	443	465	474
	Pensions		144	144	144	145	159	183
	Grants to States		147	153	133	137	148	340
	Admin and Social Services		343	333	374	434	461	482
	Plan Expenditure		511	617	716	786	897	1,160
<i>(2) Higher rural plan outlays</i>	i. Capital Expenditure		478	608	745	1,092	1,137	678
	% to GDP		2.3	2.7	3.0	4.0	3.9	1.9
	Defense		124	162	150	169	335	344
	Loans		38	51	197	487	385	59
<i>However, capex declines, due to lower loans to states</i>	Of Which Repaid to NSSF		0	0	138	462	437	0
	Plan Expenditure		316	395	399	436	477	275
	j. Plan Exp on Rev & Cap A/C		827	1,012	1,115	1,223	1,322	1,435
	k Non Plan Exp on Rev & Cap A/C		2,429	2,611	3,018	3,491	3,663	3,708
	l. TOTAL EXP (h+i) = (j+k)		3,256	3,623	4,132	4,714	4,984	5,143
Deficit Trends								
m. Fiscal Deficit (l-g)			1,186	1,412	1,451	1,233	1,280	1,511
	% to GDP		5.7	6.2	5.9	4.5	4.1	4.3
	Revenue Deficit (h-e)		850	1,004	1,079	983	795	953
<i>FRBM⁷ targets not adhered to</i>	% to GDP		4.1	4.4	4.4	3.6	2.6	2.7
	Primary Deficit (m-1)		193	334	273	-13	-15	172
	% to GDP		0.9	1.5	1.1	0.0	0.0	0.5
Financing the Deficit								
	Market Borrowings		729	877	976	889	459	1,103
	PPF & Special Deposits		134	122	161	45	42	50
	Small Savings		83	88	0	0	340	30
	Net External Assistance		75	56	-119	-135	90	97
	Others		179	281	436	442	250	200
	Budget Def/Cash Drawdown		-14	-12	-3	-9	210	31
	Total Financing		1,186	1,412	1,451	1,233	1,280	1,511

FY05 P- Provisional estimates; FY06 BE- Budget estimates.

Source: Budget documents.

⁷ The FRBM Act binds the central government to reduce its fiscal and revenue deficits each year by 0.3% and 0.5% of GDP, respectively, to eliminate revenue deficit by 2009. This, however, has not been adhered to, with the fiscal and revenue deficit estimated at 4.3% and 2.7% in FY06, respectively, compared with 4.5% and 2.7% in FY05.

Global Economic Forecasts

	GDP Growth (%)			CPI Inflation (%)			Current Balance (% of GDP)			Fiscal Balance (% of GDP)		
	2004E	2005E	2006E	2004E	2005E	2006E	2004E	2005E	2006E	2004E	2005E	2006E
Global (%)	3.9	3.2	3.3	2.6	2.8	2.5	-0.4	-0.7	-1.0	-2.7	-2.6	-2.5
Industrial Countries (%)	3.1	2.5	2.6	1.9	2.0	1.8	-1.3	-1.7	-2.1	-3.2	-2.9	-2.8
United States	4.4	3.6	3.4	2.7	2.9	2.5	-5.7	-6.6	-7.3	-3.5	-2.4	-2.1
Japan	2.7	1.8	1.4	-0.2	-0.2	0.2	3.6	3.2	3.0	-7.0	-6.9	-6.5
Euro Area	1.8	1.4	2.0	2.1	2.1	1.6	0.6	0.6	0.7	-2.7	-3.0	-3.2
Emerging Markets												
Asia (%)	7.4	6.6	6.7	4.0	3.8	3.8	4.2	4.1	3.9	-0.5	-1.8	-1.9
China	9.5	9.0	8.5	3.9	3.5	4.0	4.1	5.5	6.0	1.4	-1.9	-2.5
Hong Kong	8.1	4.5	5.0	-0.4	1.4	3.0	9.7	9.2	8.4	-0.4	0.3	0.6
India (Inflation is WPI)	6.9	7.5	7.4	6.5	5.0	4.0	-1.1	-0.9	-0.6	-4.5	-4.3	-4.0
Indonesia	5.1	5.6	5.9	6.1	7.9	7.1	1.1	0.6	-0.5	-1.2	-1.0	-0.8
Korea	4.6	3.6	4.7	3.6	3.3	3.0	4.1	3.2	2.8	0.7	0.4	0.6
Malaysia	7.1	5.5	5.5	1.3	3.3	2.5	12.6	12.2	11.4	-4.3	-3.6	-3.0
Philippines	6.1	4.3	4.8	5.5	8.8	7.3	2.4	2.1	1.4	-3.9	-3.3	-2.4
Singapore	8.4	3.7	4.5	1.7	0.6	1.7	26.1	23.1	20.0	4.0	5.0	5.0
Taiwan	5.7	3.6	4.0	1.6	1.7	1.8	6.2	6.0	4.8	-3.4	-3.3	-3.2
Thailand	6.1	4.0	4.7	2.8	3.6	3.3	4.5	-2.7	-6.7	0.3	-0.3	-1.4
Vietnam	7.7	7.0	7.5	7.8	6.5	6.0	-4.9	-4.7	-4.6	-3.5	-3.5	-3.0
Latin America (%)												
Latin America (%)	6.0	4.1	3.8	6.1	6.4	5.5	1.1	0.4	-0.3	-1.0	-1.8	-1.7
Argentina	9.1	6.1	3.5	4.4	8.8	8.6	2.0	1.7	-0.4	2.6	0.5	0.0
Brazil	5.2	3.0	3.7	6.6	7.4	5.6	1.9	1.4	1.24	-2.7	-4.2	-3.1
Chile	6.1	5.5	5.0	1.1	2.5	2.8	1.5	1.9	1.3	1.2	1.0	1.0
Colombia	4.0	4.0	3.7	5.9	5.1	5.1	-1.2	-1.8	-1.8	-1.2	-2.5	-2.8
Ecuador	7.0	3.7	3.1	2.7	1.0	0.7	-0.4	-1.3	-2.1	0.3	0.2	-0.5
Mexico	4.3	4.2	3.7	4.7	4.4	3.4	-1.3	-1.8	-2.0	-0.3	-0.3	-0.5
Panama	6.2	3.3	4.0	1.7	1.6	1.8	-0.6	-0.4	-1.0	-5.5	-4.0	-3.0
Peru	4.8	4.9	4.4	3.7	1.8	2.3	0.0	-0.5	-1.2	-1.1	-1.0	-1.0
Uruguay	12.3	5.5	4.0	9.2	4.9	6.7	-0.8	-1.0	-1.5	-0.8	-1.5	-1.0
Venezuela	17.9	5.2	4.0	21.8	17.6	18.7	13.9	8.2	1.8	-3.3	-2.0	-4.0
Emerging Europe (%)												
Emerging Europe (%)	6.9	5.3	5.5	8.5	8.4	6.8	1.6	1.8	2.5	-1.4	-0.3	-1.3
Bulgaria	5.3	5.5	5.3	6.1	4.2	3.7	-7.2	-8.0	-7.5	1.0	0.9	0.8
Czech Republic	4.0	4.3	4.0	2.7	1.7	2.5	-5.2	-3.1	-3.5	-3.0	-4.5	-4.0
Hungary	4.0	3.4	3.8	6.8	3.3	4.3	-8.7	-7.5	-8.0	-5.5	-5.2	-5.5
Poland	5.3	3.7	4.7	3.5	2.2	1.9	-1.5	-1.5	-1.8	-4.8	-4.0	-3.7
Romania	8.3	5.2	5.0	11.9	8.7	6.5	-8.0	-6.5	-6.2	-1.2	-0.3	-1.0
Russia	7.1	6.5	6.0	11.7	13.0	9.5	10.3	9.5	10.7	4.3	5.6	2.0
Slovak Republic	5.5	5.5	6.0	7.5	3.3	3.1	-3.4	-5.3	-5.0	-3.3	-3.4	-3.1
Turkey	8.9	5.0	6.5	8.6	7.7	6.6	-5.2	-4.7	-4.0	-7.2	-6.0	-5.0
Ukraine	12.1	6.0	5.0	9.0	14.4	11.5	10.5	6.1	4.0	-3.3	-1.6	-1.0
Africa (%)												
Africa (%)	3.9	4.5	4.1	4.0	5.5	6.2	2.1	2.8	2.0	-1.5	-1.9	-2.3
Algeria	4.5	4.8	4.8	5.0	4.4	4.0	13.8	16.5	14.0	2.0	2.0	2.0
Cote d'Ivoire	1.6	2.0	2.2	1.4	2.5	2.7	-0.5	0.2	1.0	-3.0	-4.0	-3.0
Egypt	3.6	4.5	4.7	8.1	10.5	9.0	6.5	4.3	2.5	-5.9	-6.8	-7.5
Israel	4.0	3.5	3.3	0.0	0.8	1.3	0.4	-0.5	-0.4	-3.9	-3.4	-3.2
Nigeria	4.1	5.7	5.2	13.0	13.5	13.0	3.0	6.0	4.5	3.5	4.0	2.0
South Africa	3.7	4.5	3.8	1.4	3.6	6.0	-3.2	-2.9	-2.9	-1.5	-3.1	-3.0

Source: CEIC, Citigroup estimates.

Global Financial Market Forecasts

	Vs. US\$					Policy Rates (%)					Long-term Rates (%)				
	22-Jun Current	1 Month Forecast	3 Month Forecast	6 Month Forecast	12 Month Forecast	22-Jun Current	2Q05 Forecast	3Q05 Forecast	4Q05 Forecast	1Q06 Forecast	22-Jun Current	2Q05 Forecast	3Q05 Forecast	4Q05 Forecast	1Q06 Forecast
United States	NA	NA	NA	NA	NA	2.94	3.25	3.50	3.75	4.00	4.04	4.25	4.30	4.35	4.30
Japan	108.53	109.00	106.00	100.00	95.00	0.00	0.00	0.00	0.00	0.00	1.28	1.35	1.40	1.50	1.60
Euro Area	1.22	1.20	1.22	1.28	1.30	2.00	2.00	2.00	2.00	2.25	3.22	3.45	3.35	3.50	3.60
China	8.28	8.28	7.87	7.87	7.87	3.60	3.60	3.85	4.10	4.35	3.07	3.50	4.50	4.75	5.00
Hong Kong	7.77	7.78	7.79	7.80	7.80	3.26	3.50	3.70	4.00	4.15	3.37	3.40	3.50	3.75	3.78
India	43.57	43.50	43.50	43.00	42.50	6.00	6.00	6.00	6.00	6.00	6.87	7.25	7.50	7.38	7.50
Indonesia	9,652	9,650	9,300	9,100	9,000	7.25	7.25	7.50	7.50	7.50	11.11	11.10	10.85	10.70	11.00
Malaysia	3.80	3.80	3.80	3.72	3.72	2.70	2.70	2.95	2.95	3.30	3.45	3.50	3.65	3.75	3.90
Philippines	55.63	55.75	56.25	55.25	56.30	7.00	7.00	7.50	7.75	8.00	10.83	10.85	10.95	11.20	11.25
Singapore	1.67	1.67	1.65	1.61	1.57	2.06	2.15	2.25	2.40	2.50	2.69	2.70	3.00	3.20	3.20
Korea	1,009	1,000	980	950	930	3.25	3.25	3.25	3.25	3.25	4.06	3.95	4.10	4.50	4.60
Taiwan	31.31	31.25	31.00	30.50	30.00	1.27	1.33	1.42	1.50	1.55	1.88	1.95	2.00	2.20	2.30
Thailand	41.11	41.50	39.75	39.25	38.75	2.50	2.50	2.75	3.25	3.25	3.91	4.60	5.00	5.15	5.30

Source: Citigroup estimates.

Disclosure Appendix

ANALYST CERTIFICATION

This research report contains commentary and analysis by Rohini Malkani and Anushka Shah. Each of these individual analysts/strategists/economists hereby certifies that, with respect to the issuers about which they have provided commentary or analysis all of the views expressed in this research report accurately reflect the analyst's/strategist's/economist's personal views about the subject issuer(s) and its (their) securities. Each of these individuals also certifies that no part of their compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

Other Disclosures

ADDITIONAL INFORMATION AVAILABLE UPON REQUEST

Citigroup Global Markets Inc, including its parent, subsidiaries and/or affiliates ("CGMI"), may make a market in the securities discussed in this report and may sell to or buy from customers, as principal, securities recommended in this report. CGMI may have a position in securities or options of any issuer recommended in this report. An employee of CGMI may be a director of an issuer recommended in this report. CGMI may perform or solicit investment banking or other services from any issuer recommended in this report.

Within the past three years, CGMI may have acted as manager or co-manager of a public offering of the securities of any issuer recommended in this report. Securities recommended, offered, or sold by CGMI : (i) are not insured by the Federal Deposit Insurance Corporation; (ii) are not deposits or other obligations of any insured depository institution (including Citibank); and (iii) are subject to investment risks, including the possible loss of the principal amount invested.

Investing in non-U.S. securities entails, including ADR's, certain risks. The securities of non-U.S. issuers may not be registered with, nor be subject to the reporting requirements of, the U.S. Securities and Exchange Commission. There may be limited information available on foreign securities. Foreign companies are generally not subject to uniform audit and reporting standards, practices and requirements comparable to those in the U.S. Securities of some foreign companies may be less liquid and their prices more volatile than securities of comparable U.S. companies. In addition, exchange rate movements may have an adverse effect on the value of an investment in a foreign stock and its corresponding dividend payment for U.S. investors. Net dividends to ADR investors are estimated, using withholding tax rates conventions, deemed accurate, but investors are urged to consult their tax advisor for exact dividend computations.

Although information has been obtained from and is based upon sources CGMI believes to be reliable, we do not guarantee its accuracy and it may be incomplete or condensed. All opinions and estimates constitute CGMI's judgment as of the date of the report and are subject to change without notice. This report is for informational purposes only and is not intended as an offer or solicitation for the purchase or sale of a security.

Investing in non-US securities by US persons may entail certain risks. Investors who have received this report from CGMI may be prohibited in certain US States from purchasing securities mentioned in this report from CGMI ; please ask your Financial Consultant for additional details.

This report is distributed in the United Kingdom by Citigroup Global Markets Limited , Citigroup Centre, Canada Square, Canary Wharf, London E14 5LB, UK. This material is directed exclusively at market professional and institutional investor customers and is not for distribution to private customers, as defined by the rules of the Financial Services Authority, who should not rely on this material. Moreover, any investment or service to which the material may relate will not be made available to such private customers. This material may relate to investments or services of a person outside of the United Kingdom or to other matters which are not regulated by the Financial Services Authority and further details as to where this may be the case are available upon request in respect of this material. If this publication is being made available in certain provinces of Canada by Citigroup Global Markets (Canada) Inc. ("CGMI Canada"), CGMI Canada has approved this publication. If this report was prepared by CGMI (excluding Nikko Citigroup Limited) and distributed in Japan by Nikko Citigroup Limited, it is being so distributed under license. This report is made available in Australia, to non retail clients through Citigroup Global Markets Australia Pty Limited (ABN 64 003 114 832), and to retail clients through Smith Barney Citigroup Australia Pty Ltd (ABN 10 009 145 555), Licensed Securities Dealers In New Zealand it is made available through Citigroup Global Markets New Zealand Limited, a member firm of the New Zealand Stock Exchange. This report does not take into account the investment objectives, financial situation or particular needs of any particular person. Investors should obtain advice based on their own individual circumstances before making an investment decision. Citigroup Global Markets (Pty) Limited is incorporated in the Republic of South Africa (company registration number 2000/025866/07) and its registered office is at Citibank Plaza, 145 West Street , Sandown, Sandton, 2196, Republic of South Africa. The investments and services contained herein are not available to private customers in South Africa This publication is made available in Singapore through Citigroup Global Markets Singapore Pte. Ltd., a Capital Markets Services Licence holder. This report is being distributed in Hong Kong by or on behalf of, and is attributable to Citigroup Global Markets Asia Limited, 50th Floor, Citibank Plaza, 3 Garden Road, Central, Hong Kong

Citigroup Global Markets Inc. is a member of the Securities Investor Protection Corporation (SIPC). © Citigroup Global Markets Inc., 2005. All rights reserved Smith Barney is a division and service mark of Citigroup Global Markets Inc. and its affiliates and is used and registered throughout the world. Citigroup and the Umbrella Device are trademarks and service marks of Citicorp and its affiliates and are used and registered throughout the world. CitiFx ® is a service mark of Citicorp . Any unauthorized use, duplication or disclosure is prohibited by law and may result in prosecution. Nikko is a service mark of Nikko Cordial Corporation.

(5628A, 5636A, 5860A)
2005-AP251