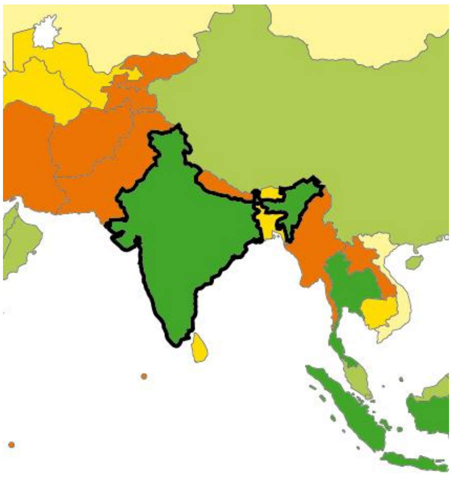
COUNTRY RISK ANALYSIS

India

CREATING CONFIDENCE IN YOUR EXPORTS



COUNTRY RISK CATEGORY

3/7

The country risk categories range from 0 to 7. The lower number the better the credit rating of the country.

0 1 2 3 4 5 6 7

EKN'S OUTSTANDING GUARANTEES ON THE COUNTRY

Short-term transactions: SEK 41.2 million

Medium and long-term transactions: SEK 16,697.4 million

EKN'S POLICY

Sovereign risks: Normal risk assessment

Other public risks: Restrictive risk assessment

Bank risks: Normal risk assessment

Corporate risks: Normal risk assessment

See also "EKN'S POLICY" section

DATE

24/10/2013

The recovery is long in coming

The slowdown in the Indian economy has become both deeper and more protracted than expected. The combination of unfavourable global conditions and the inability of politicians to come to a decision and implement the necessary reforms has compounded the situation, which means that the recovery is likely to be slow. If India is to achieve a growth rate similar to that which existed up to 2011, a substantial acceleration of reform and liberalisation initiatives will be required. Against the backdrop of deficits in the current account balance and public finances, limits are increasingly tighter on growth-stimulating measures. The country's low external debt and satisfactory level of international reserves represent strengths.

STRENGTHS

- Stable democracy with a history of wanting to pursue a responsible economic policy
- Low external debt and an adequate level of international reserves
- Dynamic private corporate sector

WEAKNESSES

- Slow reform process
- Weak public finances and large current account deficits
- High inflation and depreciating currency

POLITICS

Slow reform process

Politics in India during 2013 was marked by the slow pace of necessary reform initiatives. The minority government's lack of unanimity has made it more difficult to prioritise, focus and implement decisions. However, faced with the gravity of the situation and towards the end of the parliamentary session, the parties have started to pull together. During an extended session, several important resolutions were adopted in areas such as retail trade and land compensation. The message behind the resolutions is continuing deregulation and liberalisation with the aim of re-establishing international confidence. However, in view of the relatively far-reaching requirements associated with the deregulation, such as infrastructure investments and deliveries from Indian suppliers, there is a risk that the message will not be credible.

The government's hope of positive sentiments in the economy in the lead-up to the 2014 election is becoming increasingly unlikely. Instead, the focus has shifted to the newly launched welfare package which is expected to favour the ruling UPA coalition in the election. The welfare package concerns food subsidies. The new subsidies run counter to the fiscal policy's aim to reduce government spending. Nevertheless, there is no political scope for parties not to back the package in an election year.

In the lead-up to the election, it is unclear whether Congress Party and UPA Alliance will find the support to keep them in power for another term. Splits within the opposition and increased subsidies may give the Congress party a certain advantage. Both of the national parties, the Congress Party and the opposition BJP, play an important role as a unifying force at national level. In fundamental issues, there is consensus between the Congress Party and the BJP. However, the national parties are facing increasing competition from emerging regional parties. The shape of future policies will be related to how influential the regional parties are and how strong their demands for regional consideration are. The two national parties are expected to promote political continuity.

ECONOMY

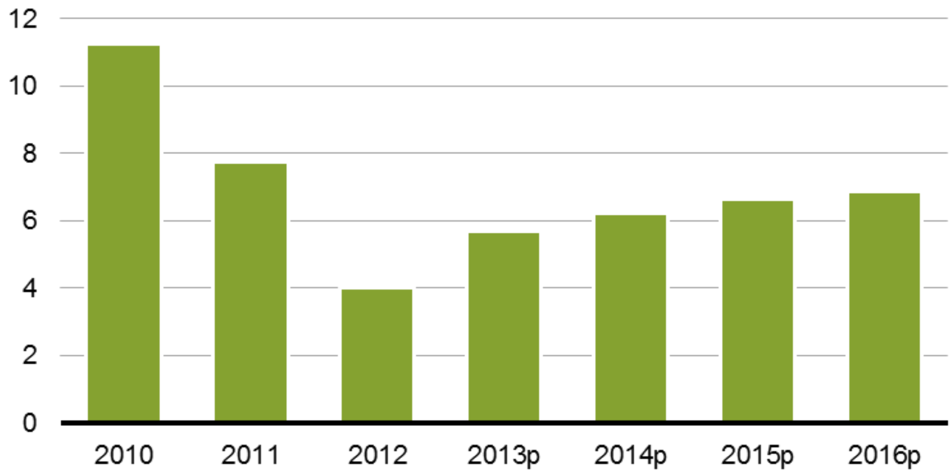
Bottom of the growth decline not yet reached

The Indian economy is going through a difficult period. As would be expected, the economic policy has focused on growth since the deregulation in the early 1990s, but despite this, growth in 2012 was the country's lowest in ten years. Indicators show that the bottom of the decline may not yet have been reached. Policy decisions that were expected and appeared to be on the cards during 2012/13 were never adopted or became too diluted to produce its full effect. The economy has been harmed by the lack of political decisions and it was not until during the extended monsoon session that important decisions finally started to be made.

General stimulus measures to counter the low growth are becoming increasingly difficult to implement in light of the deficits in the current account balance and public finances. A declining exchange rate and high inflation are imposing even tighter limits. A shift from focusing exclusively on growth to taking greater account of other factors such as exchange rate stability, inflation and public finances has emerged during the year. The fundamental strength in India's economy is its size and diversification. There is a developed services sector and an industrial sector in many segments such as manufacturing, pharmaceuticals and textiles as well as a very large domestic market.

High uncertainty and lack of confidence in the economy is resulting in reduced investment and consumption. That gives reason to believe that recovery will be slow when it gets started, which could be during the first half of 2014. It is unlikely that India will achieve the high growth rate that existed until 2011 without substantial investment, reform and deregulation. A reform of the education system, harmonisation of regulations between states, further liberalisation with the associated modernisation of institutions and updated labour market regulations are all examples that would benefit the recovery. The lack of reform has led to continuous downward revisions of forecasts and there is still a risk that growth will be lower than forecast.

GDP GROWTH,%



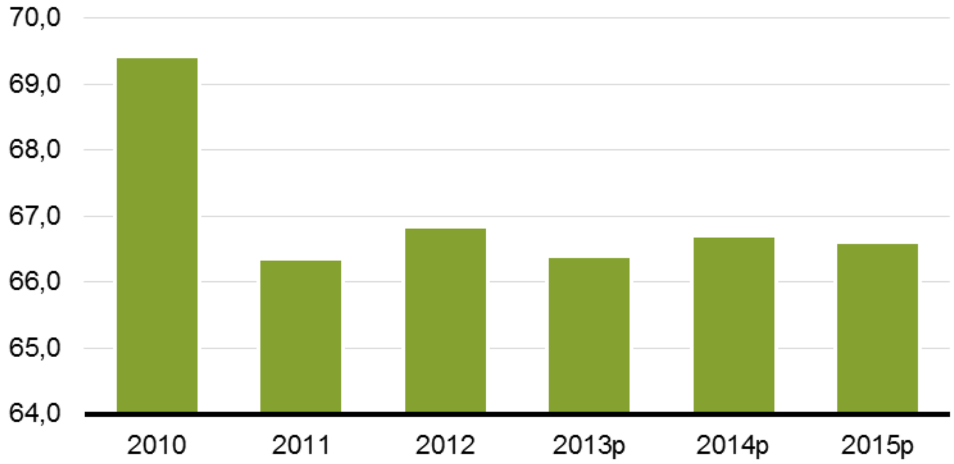
Although growth has been the stated goal, the growth rate is at a historically low level. (Source: IMF WEO, July 2013)

India's public finances have weaknesses in both revenue and expenditure. Tax revenue is approx. 16 per cent of GDP, which is low relative to comparable developing and emerging countries. Generous tax exemptions, difficulty of taxing the agricultural sector and an extensive informal economy are explanations for the low tax collection. Measures to broaden the tax base and reduce exemptions are in progress, but they will only produce their effects in the long term.

The trend of reducing the public finances deficit was broken in 2008 when major stimulus measures were taken. Subsequently, the overall budget deficit was approx. 8 per cent and only a marginal reduction is expected in the next few years. The high level of private savings and the state requirement for domestic banks to hold a large proportion of government bonds in their portfolios represent an important part of state financing. The introduction of the new subsidy programme, which is very extensive and affects about 800 million people, will increase the strain on the finances. Costs of food subsidies are expected to amount to 1.2 per cent of GDP, compared with 0.8 per cent before the programme's introduction.

Total public debt is 66 per cent of GDP, which is unchanged from the previous year and in line with the coming years. The advantageous profile, with the majority of lending being in the domestic banking system and having long maturities, means that the debt is still considered manageable. Nevertheless, interest payments represent significant expenditure in the budget, corresponding to approx. 23 per cent of total government revenue.

PUBLIC DEBT, % OF GDP



Public debt is almost exclusively domestic borrowing (Source: IMF WEO, April 2013)

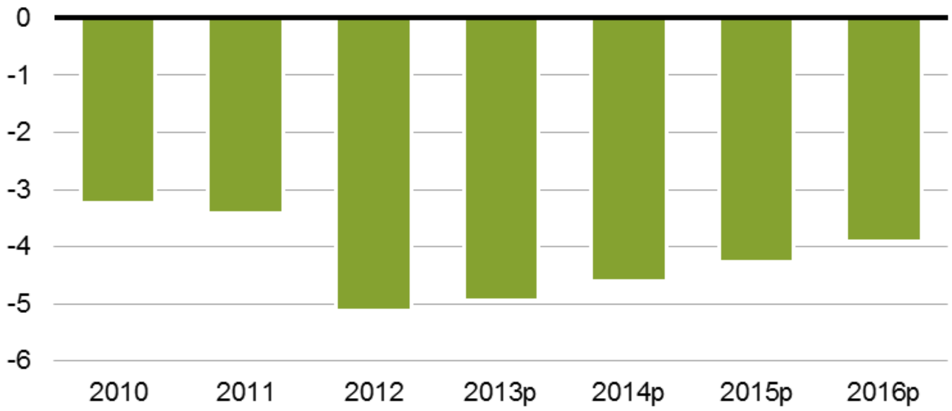
In view of the low tax collection, there is scope for improving the balance of public finances in a very long-term perspective. However, India's public finances will be weak in the next few years in the absence of reforms to increase revenue and the state will continue to have a borrowing requirement.

BALANCE OF PAYMENTS AND DEBT ISSUES

Oil prices have a significant bearing on India's external balance

High oil prices are of concern to India in several ways. They affect public finances through an increased subsidy element and result in a higher import bill, which contributes to the current account deficit. The rupee, which has fallen against the US dollar by approx. 20 per cent since the beginning of the year, has added to the import cost. The current account deficit reached a record high in 2012 at -5.1 per cent of GDP.

CURRENT ACCOUNT BALANCE, % OF GDP



High oil prices have contributed to the increase in the current account deficit. (Source: IMF WEO, April 2013)

Exports have shown a positive trend since the middle of 2013. The falling value of the rupee has helped to make Indian exports more competitive and this has been particularly evident in sectors such as textiles and pharmaceuticals. A reduction in the trade deficit from this year onwards and a stabilisation of the current account balance is expected. Despite the positive signs for exports, it should be remembered that the Indian economy is primarily driven by the domestic market. With exports accounting for just 17 per cent of GDP, India will not be able to "export its way out" of the subdued growth.

Despite the large current account deficits and reduced capital inflows for several years, India has still considerable international reserves. There has been high volatility in currency flows since 2008. However, foreign direct investment has partly compensated for the change in the more volatile portfolio investments. With the exception of 2008/09, portfolio investments have been positive, albeit fairly small in some years. Based on the resilience of foreign investment in India over the past ten years, there is reason to believe that India will also be an attractive investment country in the future.

External debt represents about 20 per cent of GDP, most of which is private debt. The trend for external debt is a slight increase. In view of the falling value of the rupee, it is a strength that external debt is not higher. All in all, it can be said that the country's external position is weakened but still relatively good. The country's international reserves are at a good level, corresponding to almost six months of imports.

CURRENCY POLICY

India has adopted a managed float regime, which means that the central bank intervenes in order to influence exchange rates. The Indian rupee has depreciated sharply against the dollar in 2013, as have several currencies in emerging countries. Factors such as expectations of a more restrictive US expansionary monetary policy, the large Indian current account deficit, increased regulatory uncertainty and cautious investors have meant that the rupee has fallen more than several other currencies.

Both the ministry of finance and the central bank took action to counter the sharpest falls. Measures included raised duties on gold imports, management of the national oil companies' US dollar needs through separate channels to avoid affecting the rupee-dollar exchange rate and tighter liquidity requirements for banks. The central bank has been clear to stress that further capital controls are not on the cards, although controls to limit private companies' borrowing abroad have been sharpened. In view of the low growth, the central bank has allowed interest rates to remain unchanged for a long time. In September 2013, it was decided to raise interest rates to curb inflation. As long as the US central bank is committed to tapering its support purchases of bonds, interest rates can be expected to rise.

The currency is convertible for current account transactions, but restrictions remain for capital balance flows and the rupee is not fully convertible. There is a system of capital controls. EKN does not have any experience in guaranteeing transactions in local currency.

FINANCIAL SECTOR

Significant state interference

In total there are about 80 commercial banks in India and the state owns about two-thirds of the sector's total assets. State Bank of India has a unique position with a market share of 22 per cent. However, private banks are expanding their market share relative to the state banks, thanks to more efficient systems. The state banks have problems obtaining new capital, which in turn limits their growth opportunities.

In 2013, it was proposed that foreign banks should be encouraged to convert their branches into domestic banking subsidiaries. If the proposal is implemented, a completely different capitalisation of the newly-established banks will be required, but in return there will also be significantly greater scope for expanding the number of branches in the country. The requirement for banks to establish branches in rural areas in proportion to the number of branches in the cities to increase availability is likely to remain. Some of the already established branches are likely to withdraw from the market as capital requirements become too high. But analysts believe that the large foreign banks, Citibank, HSBC and Standard Chartered Bank are likely to see the benefits as compelling. There are also signs that a consolidation of the market could be on the way.

In general, regulation and supervision of banks is relatively good. However, an increase in the number of banks in the form of newly established subsidiaries rather than branches would place greater demands on the regulatory authorities. The public banks represent a weaker segment, with slightly lower portfolio quality, lower capitalisation and lower profitability. The proportion of non-performing loans in the loan portfolio is moderate and represents just over 3 per cent of total lending. For publicly-owned banks, the level of non-performing loans has increased, while the trend has been the opposite for private banks since 2008. The state's need to finance itself in the domestic banking system means that reserve requirements are generally high and banks are required to hold the equivalent of 23 per cent of net deposits in government bonds. Similarly, a high proportion of lending is directed, which means that there is a requirement for a certain percentage of bank lending to go to sectors such as agriculture or SMEs. The central bank is working with reserve requirements to manage liquidity in the banking system. Liquidity in the banking system is generally good and is based on high deposits from households backed by a government deposit guarantee. Profit levels are generally low, reflecting both the state-owned banks' inefficiency and the fierce competition in the market. On previous occasions, the Indian state has gone into weak or non-functioning banks and taken over the business or demanded a merger. This has been the case with both state-owned and private banks.

The Indian banking sector is still regulated in several respects (establishment, expansion, directed lending, interest rates etc.) and it is vital for the state to retain influence over the sector as it is the primary source of funding. This state of affairs will continue and steer the governance of the sector in a direction that is less market-based.

BUSINESS ENVIRONMENT

Red tape

India has an unflattering position in the World Bank's 2013 Ease of Doing Business rankings, occupying 132th place (of 183). This is lower than the country's neighbours Bangladesh (129), Pakistan (107) and Sri Lanka (81). The ranking is unchanged from the previous year. The administrative complexity is permeating the business environment and the consequence is that it is, for example, both difficult and time consuming to pursue any form of authorisation or bankruptcy process. Legislation also gives the borrower substantial rights, which means that recourse to collateral provided for loans can often be difficult in the event of payment problems. The red tape and unintelligible bureaucracy creates a breeding ground for corruption.

There is significant state interference in private business transactions. The central bank regulates private foreign borrowing by Indian companies by measures such as minimum maturity requirements. There is also a requirement that there must be an domestic Indian importer acting as dealer.

Access to financial information for private companies has improved and is usually good for large and medium-sized enterprises in India. However, for small enterprises, financial information can still represent a problem. All financial reporting for SMEs takes place in accordance with local standards. IFRS standards are often used by larger companies and a general transition to IFRS is planned. The tax year runs from 1 April to the end of March, which means that many companies also have a split financial year for their financial reporting. Sweden has a bilateral investment treaty with India and the country has acceded to the New York Convention *(The Convention on the Recognition and Enforcement of Foreign Arbitral Awards),* which has a positive effect on companies' ability to insure investments with EKN's investment guarantees.

Over the past ten years, private companies in India have increasingly used the international capital market to obtain financing. This means that the recent sharp depreciation affects companies with foreign currency debt and local earnings and companies that import inputs. The hardest hit companies are those that have a combination of both.

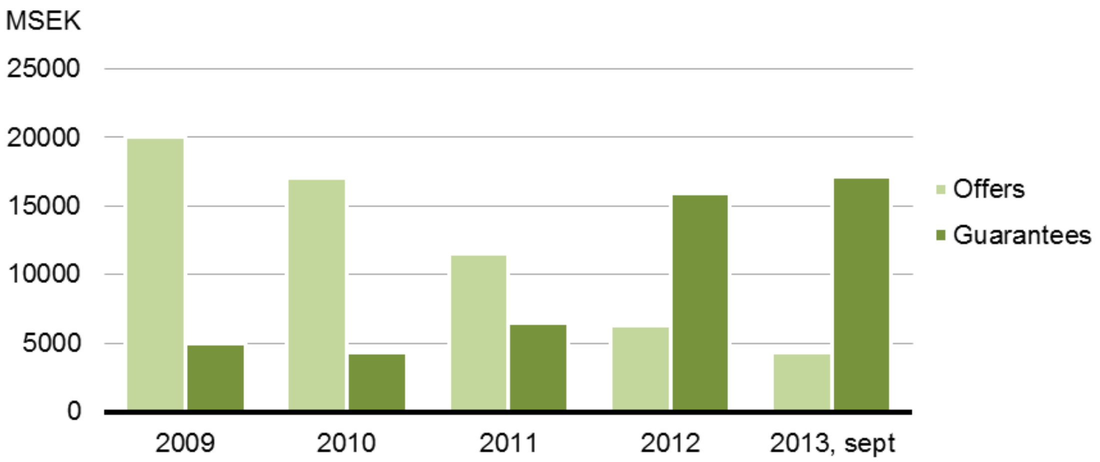
EKN'S EXPOSURE

Large transactions dominate

EKN's exposure in India is dominated by a handful of large transactions which account for the vast majority of the total exposure of SEK 21.8 billion. Guarantees represent the largest proportion of the exposure, accounting for SEK 16.8 billion of the exposure. Outstanding guarantees are essentially divided into two sectors, power and telecom. The existence of a small number of large transactions means that changes, from application to offer or from offer to guarantee, involve large amounts.

EKN's exposure in India consists mainly of loss on claim guarantees for long credit periods EKN sees few letter of credit guarantees as the Swedish banks' risk appetite and bank credit facilities are adequate. EKN has only been asked about risk sharing in letter of credit guarantee transactions for very substantial amounts.

OFFERS AND GUARANTEES AT 31 DEC EACH YEAR



The total exposure, offers and guarantees, amounts to approx. SEK 20 billion. (Source: EKN)

PAYMENT EXPERIENCE

Good payment experience

EKN's payment arrears and losses on transactions in the country are very small in relation to the exposure. Imports on open credit are common and EKN has generally positive experience of these.

Arrears occur to a limited extent and often involve small private debtors. In the last five-year period, EKN has been involved in three claims settlements. There are claims in five transactions and for EKN's part, these amount to SEK 7.2 million.

EKN'S POLICY

Policy in brief

For transactions with private sector risk, such as banks and companies, EKN does not have any specific general restrictions; instead, each transaction is assessed on its own merits. This applies whether the transaction has a short credit term (under one year) or a longer term. The same applies to transactions with central state debtors, such as the central bank or finance ministry.

However for other public buyers, such as other ministries or municipalities, EKN has a more restrictive approach. EKN normally requires government guarantees for these transactions and if such a guarantee is not available, EKN imposes higher requirements such as good financial visibility.

OFFICIAL COUNTRY DATA AND CREDIT RATINGS

OFFICIAL COUNTRY DATA

Area: 3,288,000 km² (7.3 times Sweden)

Population: 1,250 million (2013 est.)

Population growth: 1.4% (average p.a. 2005-2010)

GDP: USD 1,873 billion, 2012 est. (Sweden USD 527.7 billion, 2012)

GDP/capita: USD 1,523, 2012 est. (Sweden USD 56,210, 2012)

CREDIT RATING

	COUNTRY CEILING	SOVEREIGN RATING
Moody's:	Baa2/	Baa3/Stable
S&P:	BBB+	BBB-/Neg
Fitch:	BBB-	BBB-/Stable

COUNTRY ANALYST

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DISCLAIMER

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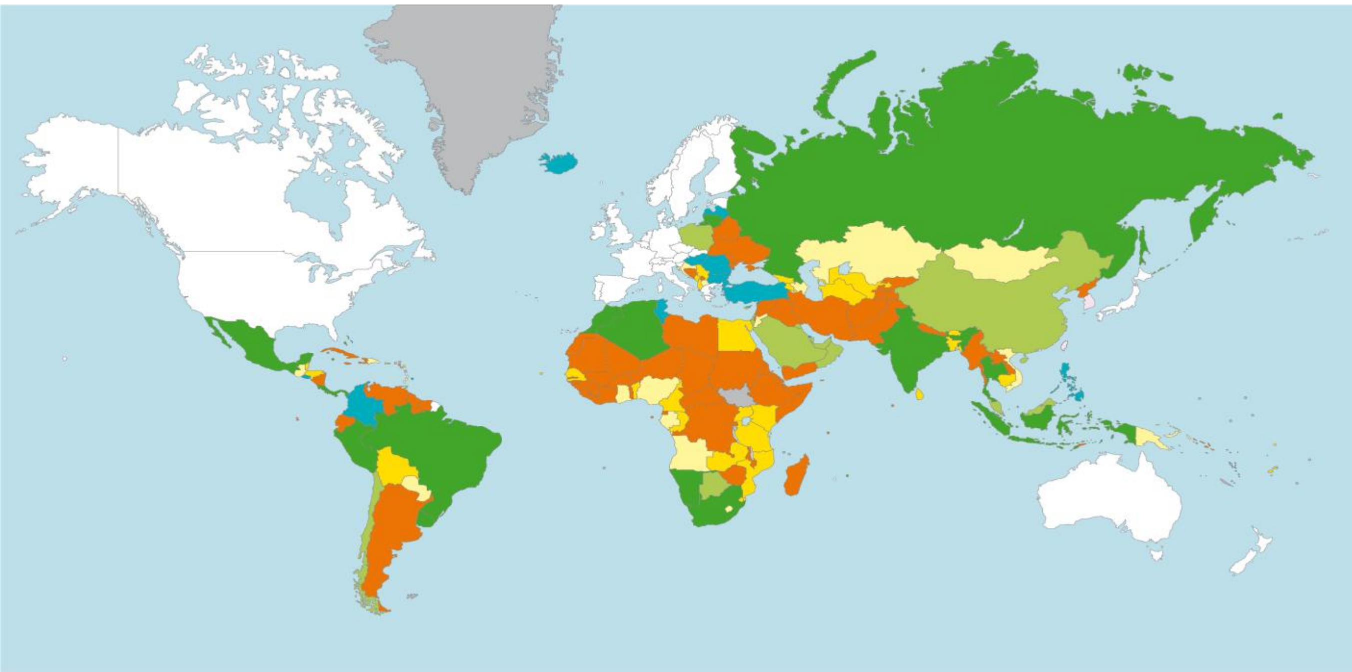
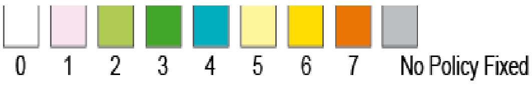
EKN'S VIEW OF THE WORLD



The country risk categories range from 0 to 7.
The lower number the better the credit rating of the country.



EKN – CREATING CONFIDENCE IN YOUR EXPORTS

EKN is a government agency that supports Swedish exports and the internationalisation of Swedish industry. This we do by offering exporting companies and banks guarantees for payment and financing, together with advice on business structure and risk management. Our services provide an extra level of confidence, increased competitiveness and more opportunities for successful export transactions.

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