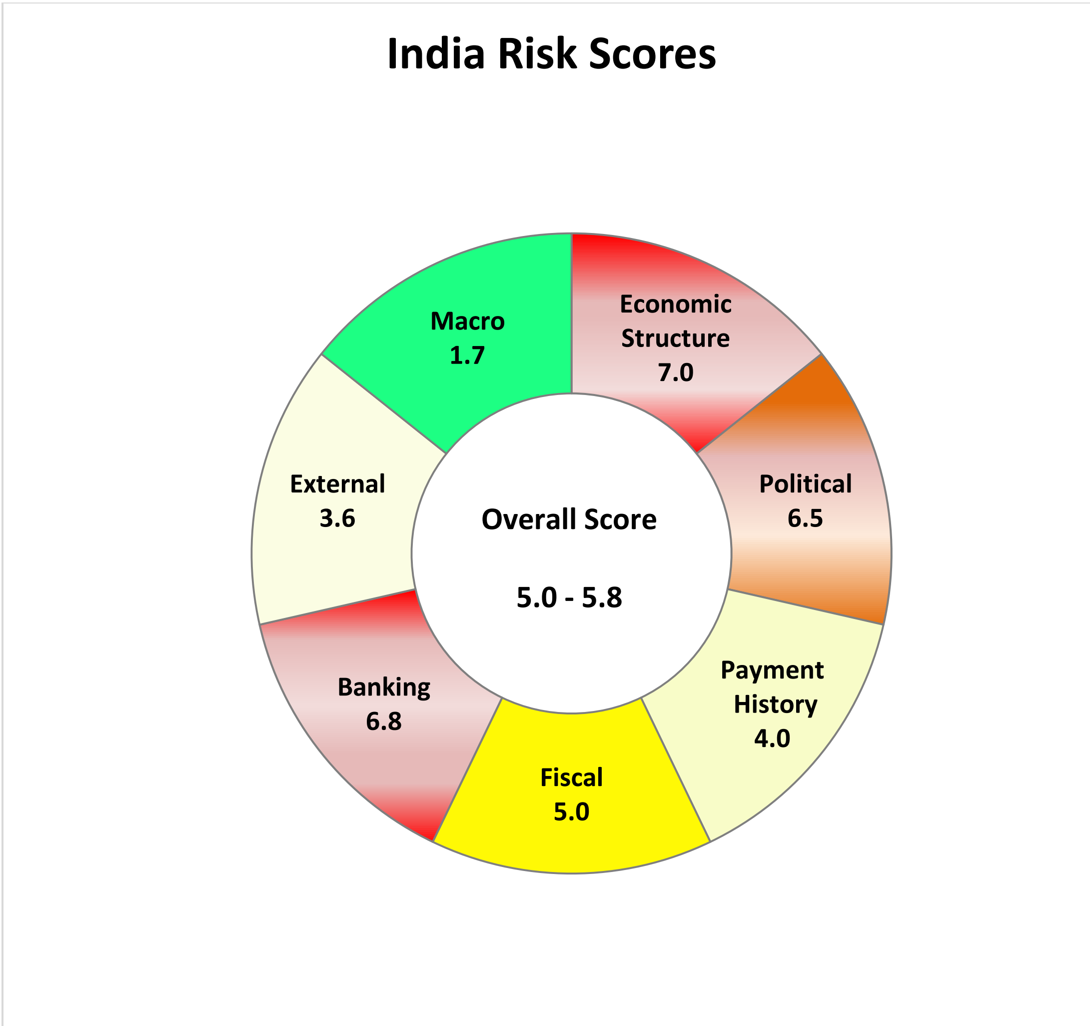

India Trend Risk

Despite sustained annual growth of 6-7% for several years, India remains a low-income country with more than one-fifth of the population in poverty. Strong trade performance will boost growth to 7.5% in 2017. Structural reforms in labor and corporate law could enhance the weak investment climate, which ranks 130th in World Bank surveys. Inflation has halved to 5%, due to lower oil prices and inflation-targeting, which has moderated price expectations.

Banking risks are quite high in India. Non-performing assets exceed 31% of bank capita, and corporates, the main borrowers from the banking system, have heavily leveraged balance sheets and weak profit performance. India also reflects a very low inclusion rate for women and lower income households. Very low liquidity ratios point to another vulnerability in the system.

India has made limited progress on its fiscal problems. The general budget deficit is high at nearly 7% of GDP, due to extensive subsidies and transfers to the states. Public debt is also quite high (69% of GDP), but benefits from long maturities and captive domestic funding.

External accounts are solid, despite slower trade in Asia. Export volumes rose nearly 6% over the past year, and India's terms of trade surged. The current account deficit is modest, foreign investment is strong, and foreign exchange reserves exceed 7 months of imports. A flexible exchange rate further supports the external balances.

The activist government of Prime Minister Modi recently completed its second year in office, with three years remaining. Recent poorly thought-out reforms, such as elimination of large currency notes, underscore the difficulty of implementing structural reforms in India. A complex multi-party system and upcoming state elections create additional obstacles to needed change.