

### India: Contagion from euro area's economic woes augurs a tricky year for India

> **Event:** Most recent data, such as a rare decrease in industrial production, underline an accelerated slowing down of the Indian economy, which negatively affects its fundamentals. Therefore, the authorities have revised downwards their growth forecasts from 9 to 7.5% for the fiscal year ending next March. This is a consequence of the constant monetary tightening since 2010, which has progressively harmed domestic demand. Moreover, despite some easing of consumer price inflation, the latter remains robust at 9% as it is partly fuelled by the strong depreciation of the Indian rupee against the USD, 20% since August, to a record low. The rupee's fast decline is the worst currency evolution seen in Asia and will contribute to a widening of India's current account deficit in the short term through more expensive imported goods, which will in turn put more pressure on the rupee. The main explanation lies in the repatriation of European capital (portfolio and FDI) underlying the credit crunch within the EU.

> **Impact on country risk:** The fast slowdown in economic activity increases the risk of a more severe step backwards if the euro area crisis worsens and a more pronounced global economic downturn hits western demand, notably for Indian services. Prime Minister Manmohan Singh's government has limited room for manoeuvre compared with most of his Asian peers because public finances are weak and the political decision-making process is hindered, as a result of which important projects are put on hold and economic reforms (e.g. fiscal reform) are delayed. A more accommodating monetary policy might be a difficult option as public borrowing is rising in order to finance the budget deficit, which might continue to put upward pressure on interest rates. In any case, commercial risk is likely to deteriorate in 2012 due to more costly external debt repayments. (**analyst:** Raphaël Cecchi, r.cecchi@ondd.be)