D&B ECONOMY OBSERVER

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Containing the fiscal deficit at 4.6% for FY14 (Interim Budget) far below the budgeted target of 4.8% amidst an economy growing at only 4.9% (advanced estimate) was clearly unexpected. In fact, it was highly anticipated that the government might not be able to meet its fiscal deficit target as it had reached 95.2% of its budgeted target by Dec-2013. This was the second consecutive year when the fiscal deficit had been contained below the targeted level. Fiscal deficit stood at 4.9% during FY13 lower than the target of 5.1%. It is to be noted that the fiscal deficit target has been over-achieved during both the years when the Indian economy had been growing at a decade low. Fiscal consolidation bodes well for the overall economy averting the possible downgrade by the international rating agencies. However, the implications of a lower fiscal deficit achieved through reducing capital expenditure in a slow growing economy needs to be evaluated cautiously.

The attainment of better than expected fiscal deficit target in FY14 has been through offsetting the decline in tax revenue through expenditure compression. Plan expenditure has been pruned to the tune of 14.4% decline from the budgeted estimates while non-plan expenditure exceeds the budgeted target by 0.4%. The concern is that both the plan as well as non-pan capital expenditure has been curtailed during FY14. Further, under the revenue expenditure, the grants for creation of capital assets has also fallen significantly (30.6%) compared to the budgeted estimates. Within the tax revenue, corporation tax, income tax, wealth tax customs and excise duties had recorded a major shortfall. The significant 12.2% increase in non-tax revenue led by the 19.4% increase in dividend and profits of the public sector units, helped to offset to some extent the fall in the tax revenue. The windfall gain being the collection through the 2G spectrum auction which helped in non-tax revenue augmentation. The national small savings collections which were 100% more than the budgeted amount also acted as a buffer. Baring no exception to the previous years, this year also the subsidies of the government has exceeded the budgeted amount, thereby enhancing the non-plan revenue expenditure. Despite the rollover of ₹ 350 bn of fuel subsidy burden into FY15 the total subsidies for FY14 stood at ₹ 2.6 trillion - a 10.6% increase from the budgeted estimates. Going ahead the ₹ 1.15 trillion allocated for food subsidy for FY15 along with the fertilizer and fuel subsidy will pose a huge burden on fiscal position of next government.

It is an interim budget and the final allocations might be altered when the new government is formed. It remains to be seen how the new government imparts fiscal discipline. Balancing the budget would not be easy without implementing the necessary reforms on both the tax and expenditure fronts, the primary being the Goods and Service Tax (GST) and Direct Tax Code (DTC).

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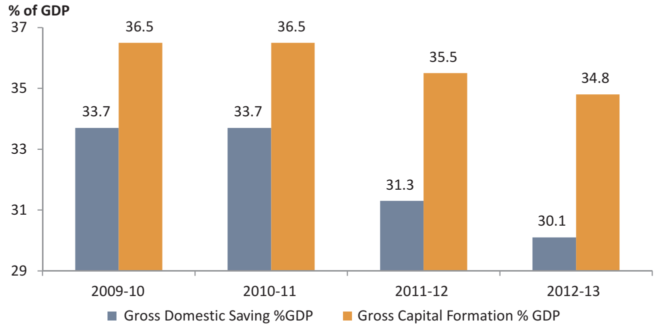
Macro Scan

Widening of Saving - Investment Gap

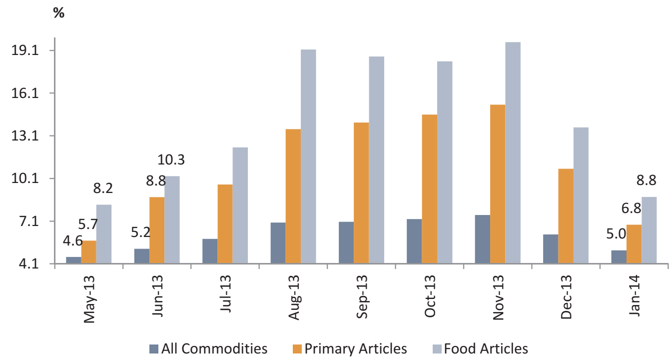


Source: MOSPI

Real Sector

- The Index of Industrial Production (IIP) and manufacturing sector declined for the third month in a row by 0.6% (y-o-y) and 1.6% (y-o-y) respectively in Dec-13.
- The mining sector witnessed a moderate growth of 0.4%, whereas electricity sector grew by 7.5% during Dec-13.
- The capital goods sector registered a decline of 3.0% in Dec-13 while on the other hand the intermediates goods sector grew by 4.5% during the same period.
- The consumer durables sector declined for the thirteenth month in a row by 16.2% in Dec-13.The consumer goods segment declined by 5.3% in Dec-13, the third continuous decline.
- Eight core industries grew merely by 2.1% in Dec-13 as compared to 7.5% in the year ago period led by poor performance in the natural gas, petroleum and coal sectors .

Prices at Eight Month Low

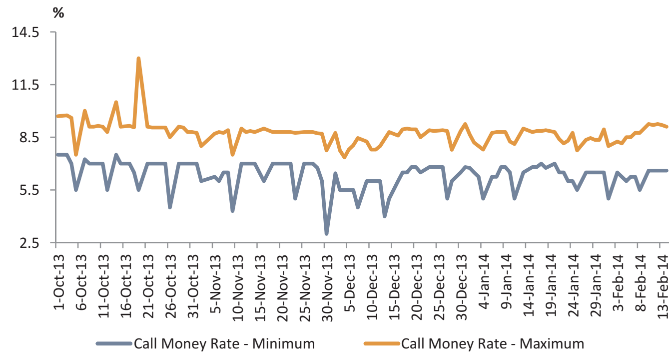


Source: Ministry of Commerce & Industry

Price Scenario

- WPI inflation at 5.0% in Jan-14 stood at a eight month low, primarily led by the strong moderation in the inflation for primary and food articles.
- Inflation in primary articles and food articles grew by 6.8% and 8.8% respectively in Jan-14 as compared to 10.8% and 13.7% during Dec-13.
- Inflation in the fuel group moderated slightly to 10.0% during Jan-14 as against the growth of 11.0% in Dec-13, whereas inflation in manufactured products inched upwards by 2.8% during the same period as against 2.6% in the preceding month.
- The CPI inflation (combined Rural and Urban) grew by 8.8% in Jan-14; the lowest growth in last 24 months.
- The core CPI (combined Rural and Urban) inflation remained unchanged at 8.1% in Jan-14 as against Dec-13.

Movement of Call Rates in H2 FY14

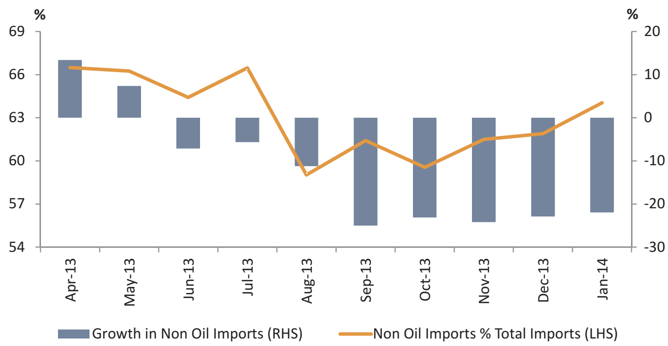


Source: RBI

Money & Finance

- In the third quarter review of Monetary Policy, the RBI increased the repo rate under the liquidity adjustment facility (LAF) by 25 basis points to 8.0% from 7.75%
- Aggregate deposit and bank credit grew by 15.7% (y-o-y) and 14.7% (y-o-y) respectively in Jan-14 as compared to 13.1% and 16.0% in Jan-13.
- Significant growth has been witnessed in deployment in bank credit to service sector (17.4%), priority sector (17.3%) and personal loans (15.8%) during Dec-13 as against the growth of 10.9%, 13.5% and 13.8 respectively in Dec-12.
- During Jan-14, RBI injected ₹ 9.9 Tn as against ₹ 8.6 Tn Dec-13. Weighted average call money rate touched almost three month high to 9.0% on 13-Feb-2014.

Performance of Non-Oil Imports



Source: Ministry of Commerce and Industry

External Sector

- India's trade deficit stood at US$ 9.9 bn during Jan-14 as against US$ 19.0 bn in the comparable period last fiscal.
- Non-oil imports during Apr-Jan, 2013-14 declined by 12.3% to USD$ 238.9 bn, whereas oil imports grew by 1.2% during same period to USD$ 138.1 bn.
- FDI inflows in equity fell by 2.4% (y-o-y) to US$ 15.5 bn during the period Apr to Nov 2013. FDI inflows in equity were US$ 15.8 bn during Apr to Nov 2012.
- FIIs invested around US$ 2.2 bn in Jan-14 as against US$ 3.5 bn in Dec-13 whereas in Jan-13 the investments were around US$ 4.6 bn.

Dun & Bradstreet's Macro Economic Forecasts

	Forecast	Latest Period	D&B's Comments
Inflation W.P.I	4.8% - 5.0% Feb-14	5.05% Jan-14	The inflation in food and primary articles has moderated during the past few months, partly due to seasonal factors. However, the elevated fuel price and weak rupee are an area of concern
Inflation C.P.I (combined rural and urban)	8.4% - 8.6% Feb-14	8.79% Jan-14	
Exchange Rate INR v/s US$	62.20 - 62.40 Feb-14	62.08 Jan-14	Dollar demand from importers and rollback of stimulus measure by the US Federal Reserve are likely to pressurize rupee in the near term
I.I.P Growth	(-)1.5% - (-)0.5% Jan-14	-0.56% Dec-13	The sustained decline in the consumer goods sector along with the dismal performance of the overall manufacturing sector and soaring interest rates are likely to keep the Index of Industrial Production (IIP) growth restrained going ahead
GDP Growth	5.0% Q3 FY14	4.8% Q2 FY14	
15-91 days T-Bills	8.5% - 8.7% Feb-14	8.58% Jan-14	Given tight government spending, tight liquidity condition and higher policy rates, both the short-term and long term yields are likely to remain elevated
10 year G-Sec Yield	8.6% - 8.8% Feb-14	8.73% Jan-14	
Bank Credit*	14.7% - 14.9% Feb-14	14.69% Jan-14	

All figures are monthly average

* Refers to End Period

Insurance - On the road of transformation

Insurance holds a significant place in the modern economy since risk, which can be insured, has increased immensely in every walk of life. This has led to growth in the insurance business and development of various types of insurance covers. The insurance industry acts as a mobiliser of savings, a financial intermediary and a promoter of investment activities. The Indian insurance industry has grown significantly over the past decade, which is evident in strong growth witnessed in insurance premium, increase number of players, product modernization and enhanced regulatory framework. However, during the last couple of years, the life insurance industry went through a transition phase that has changed the dynamics and approach of the insurance players. After a strong growth phase, the business environment has been challenging for life insurance companies. This has been on account of a combination of factors including slowdown in GDP growth, inflation, high interest rates and uncertainty on other macro-economic and regulatory parameters that impacted investors' sentiment. As a consequence, insurance players are struggling with slow growth, rising costs, deteriorating distribution structure and other constraints. A number of regulatory changes aimed primarily at encouraging need based selling of insurance products have resulted in industry players re-configuring their product mix and distribution structure. The industry players are regulating their cost structures to align their business model to the regulatory and macro-economic environment.

Ushering customer-friendly reforms

In 2013, a number of new regulations and guidelines affecting multiple facets of the insurance industry were issued by Insurance Regulatory and Development Authority, IRDA. The IRDA has been tightening and standardizing the rules of the business to protect the policy holders' interest and to establish life insurance as a long term contract. The current year would see a major change in the way business is conducted in the insurance industry. Most life insurers would be re-launching their product suite in view of the new product guidelines. Some of the key guidelines that will plug the various loopholes and, in effect, make insurance products more customer-friendly and transparent are as follows:

Increased Death Cover : The new products will come with a higher death cover and offer a higher minimum sum payable on death. For regular premium policies, the regulator has directed that the minimum sum assured or death benefit will now be higher of 10 times the annual premium for policy holder below 45 years and above 7 times for 45 years and above. At any point, the death benefit will have to be at least 105% of all premiums paid till date. Through this, the regulator aims to promote life insurance for its core value of protection.

Less Penalty for Surrendering: Guaranteed surrender values (GSV) of traditional plans for the customers have been defined and increased substantially in the new regulations. As per the new rules, a policy holder will become eligible for a surrender value after paying premiums for two years, in case the premium-paying term is less than 10 years. If the premium-paying term is more than 10 years, there will be a GSV after 3 years. The minimum guaranteed surrender value will be 30% of all premiums paid going up to 90% of the premiums paid in the last two policy years. This would allow the policyholder to liquidate his/her money in the event of exigencies. The change in product structure would prompt insurers to increase their focus on customer retention and need based selling.

Revamped health insurance norms:

- In an attempt to improve service standards in the health insurance sector and to eliminate ambiguity and reduce turnaround time in claims settlement, the IRDA has rolled out guidelines that will result in standardization in two areas—terminology and claim processes. About 46 most commonly used definitions/terms/conditions in health insurance policies have been standardised. This will go a very long way in ensuring that all health insurance policies are understood in a standard way by consumers. The regulator has also standardised pre-authorisation and claims forms to streamline processes at all stages.
- Lifetime health cover has been made mandatory and the entry age-limit has been enhanced to 65 years. This will ensure that you will not be left without a cover when you need it the most at an advanced age.
- The new guidelines have redefined the role of Third Party Agents (TPAs). The insurance company, not the TPA, has the responsibility of settling or rejecting claims. TPAs can only process claims.
- The most significant development is that the new regulations do not allow insurers to load the premium if there has been a claim in a health policy, thereby putting an end to the predatory pricing practices. Increase in premium (over and above the notified premium for that age) due to claims will be allowed only if the claim amount has been at least 5 times the annual premium in each of the 3 years preceding the year of loading . This would ensure that a single large claim will not lead to increase in the premium and only if repeated claims are made in 3 consecutive years will loading be allowed (that too if it had originally been provided for in the policy document).

Technology as a game changer

Technology is going to drive the way for conducting insurance business in future. Going forward, insurance spending on IT is expected to increase as evolved technology led distribution and simple transparent products will drive growth. Insurers in India are working to digitalize processes - especially at the front end to enhance revenue through better reach and by offering comfort to customers. The regulatory decisions on distribution, products and processes like allowing e-KYC, launch of e-insurance account - which digitizes all insurance policies in one place online and the Integrated Grievance Mechanism System are huge steps forward.

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