

Rising Expectations for Progress in Economic Reforms in India

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15 MAY 2017

(ORIGINAL JAPANESE VERSION RELEASED ON 20 APRIL 2017)

The Bank of Tokyo-Mitsubishi UFJ, Ltd.
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Major Asian currencies remain overall stable in the midst of growing geopolitical risks over Syria and North Korea (see chart 1). The main reason behind the stability of major Asian currencies is that the economies in the region are on a recovery path and their economic fundamentals become stronger than in the past through economic reforms and political stabilization. Particularly, in India where the five-state assembly elections were held in February through March, the ruling Indian People's Party, led by Prime Minister Narendra Modi, won a larger-than-expected victory in many states including Uttar Pradesh, the country's most populous state. Additionally, the Upper House passed four bills related to the implementation of the Goods and Services Tax (GST) early in April. Amid growing interest in the strong leadership of PM Modi, expectations of progress in the economic reforms help push up the rupee.

Looking at the real economy of India, demonetization of high-value banknotes last November (see note below) and a banknote shortage due to the delay in supply of new banknotes caused a disruption in economic activity towards the end of last year, which resulted in a slowdown in consumption of expensive durable goods such as automobiles or motorcycles. However, since the beginning of this year, a shortage of currency in circulation has started to be eased, while major economic indicators have shown improvement (see chart 2).

The Indian economy is expected to continue to maintain higher growth driven by strong domestic demand. The Reserve Bank of India (RBI) has already shifted its monetary stance to neutral due to an improvement in growth prospects. The RBI would continue to implement a monetary policy by considering economic conditions, as interest rates in the US, which influence the monetary policy stance in India, are anticipated to increase at a more moderate pace than in the past. Meanwhile, the smooth introduction of the GST scheduled for July and the inflation trend are among near-term risks. It is reported that sufficient preparations are not made towards the July introduction of the GST especially among small to medium-sized enterprises, suggesting that there might be a possibility of disruptions in the process to implement the GST in future. Furthermore, the inflation rate, particularly for agricultural products, might increase depending on the monsoon rainfall, which would lead to a slowdown in strong domestic demand growth. Therefore, close attention should be paid to these near-term risks.

Note: The Indian government implemented demonetization of Rs.500 and Rs.1,000 notes on Nov. 9, 2016 and introduced new Rs.500 and Rs.2,000 notes in exchange for the old ones. Currency holders were allowed to exchange the old banknotes for the new ones until Dec. 30 either over the counter of bank branches or by way of deposits in banks. Although the government placed the cash withdrawal limit for ATMs and the over-the-counter exchange of the old currencies, the withdrawal limit has been removed before the middle of March this year.

Chart 1: Major Asian Currency Exchange Rates against USD

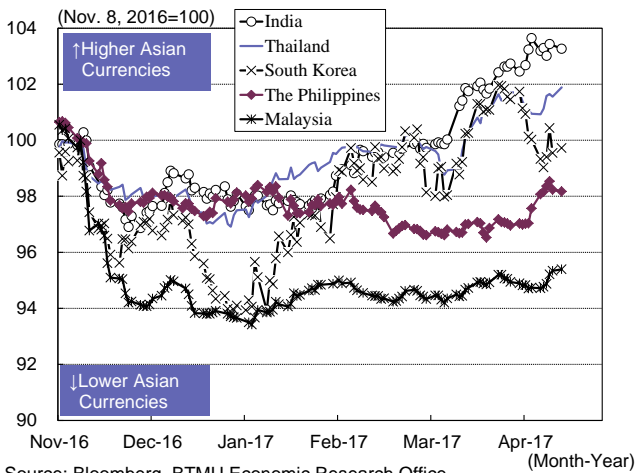
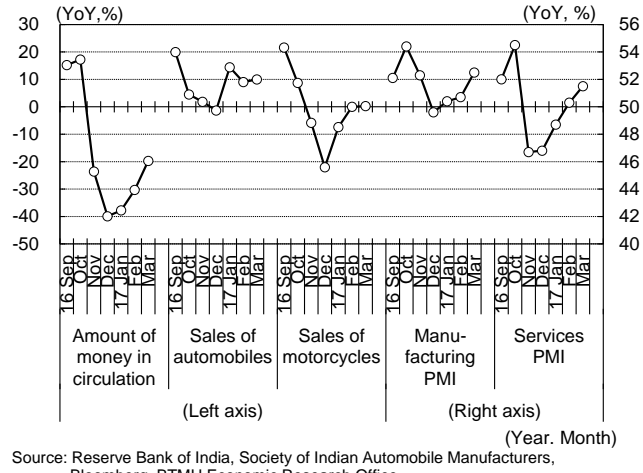


Chart 2: Changes in India's Major Economic Indicators



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