BREXIT and India

July 11, 2016
A Maze of linkages in Europe

Europe’s Ties That Bind

The U.K.’s plan to leave the European Union has focused attention on long-standing pacts that govern trade, immigration and the common currency

European Union
28-nation single market of free trade and shared regulation; includes “free movement” of goods, services, capital and people

Euro Zone
19 countries using the euro currency

European Economic Area provides access to single market in exchange for payments; has “emergency brake” on free movement of people

European Free Trade Association
Free-trade zone and network of agreements with other countries

Customs Union
Circulates goods without duties, has uniform system for handling imports

Schengen Area
26-country passport-free travel zone

Source: Bloomberg
BREXIT: Uncertainty is the only certainty

- UK is the second largest economy in the Union. Its redefining its relation with EU brings it into unchartered territory
- Europe looks weak and rudderless
  - Task of keeping EU together
  - How it will play out, depends on how negotiations will proceed.
- London as a financial Centre- No single candidate in Europe to take over the role of London
- BREXIT has added to the fragility, volatility and uncertainty in the global economy
BREXIT: Channels of transmission

- Financial
  - Contagion effects via financial market disruption and currency volatility

- Economic
  - Growth impact on UK, Eurozone

- Political
  - Referendum in Italy and Hungary
  - Elections in France (2017), Germany (2017) and referendum in Italy mean that real negotiations can only start after mid 2017
  - Negotiations will be difficult as EU would not like to set precedent for an easy withdrawal.
  - Weaken confidence and investment outlook
Growth Impact on UK and Eurozone

To avoid a recession we assume:

- UK will slash its policy rate to ‘0’ by the end of 2016
- It will re-start the quantitative easing program in 2017
- Has already announced reduction in corporate tax rate and reduced countercyclical buffers for banks
- Impact on Eurozone depends on resilience of domestic demand

Source: S&P Global, 2016
Indian macros: Will Brexit spoil the party

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<tbody>
<tr>
<td>GDP growth (%)</td>
<td>5.6</td>
<td>6.6</td>
<td>7.2</td>
<td>7.6</td>
<td>7.9</td>
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<tr>
<td>Inflation (%)</td>
<td>10.2</td>
<td>9.5</td>
<td>6.0</td>
<td>5.0</td>
<td>5.0</td>
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<tr>
<td>CAD / GDP (%)</td>
<td>4.7</td>
<td>1.7</td>
<td>1.3</td>
<td>1.1</td>
<td>1.3</td>
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<tr>
<td>Fiscal deficit / GDP (%)</td>
<td>4.8</td>
<td>4.6</td>
<td>4.0</td>
<td>3.9</td>
<td>3.5</td>
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<tr>
<td>Exchange rate (Rs/$, March-end)</td>
<td>54.4</td>
<td>60.1</td>
<td>62.6</td>
<td>66.2</td>
<td>66.5</td>
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<tr>
<td>10-year yield (March-end)</td>
<td>7.9</td>
<td>8.8</td>
<td>7.7</td>
<td>7.5</td>
<td>7.3</td>
</tr>
<tr>
<td>Investment / GDP (%)</td>
<td>34.1</td>
<td>33.0</td>
<td>32.3</td>
<td>31.6</td>
<td>31.7</td>
</tr>
<tr>
<td>GNPA / advances (%)</td>
<td>3.3</td>
<td>3.8</td>
<td>4.3</td>
<td>6.8</td>
<td>7.7</td>
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Source: CRISIL, CSO, MOF, RBI, NPA is non performing assets of the banks,
Indian growth dynamics

Global Growth

Pay Commission / OROP

Normal monsoons

Low crude / commodity price

Faster interest rate transmission

Private consumption

Capacity utilisation

Public investment

Fiscal target

Private corporate investment

H1

2016-17

H2
Impact on India Inc.

- Indian companies are likely be impacted via:
  - Demand weakness on account of potential slowdown in the EU and the UK;
  - Volatility in commodity prices, currency impact
  - Translation losses for companies with significant operations in the UK and the EU;
  - Balance sheet impact on account of exposure to unhedged overseas borrowings.
Sectoral exposure to EU and UK

Source: CRISIL, CSO, MOF, RBI, NPA is non performing assets of the banks,
Thank you

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