SECTOR OVERVIEW

A. Economic Overview

1. India's economy has had robust growth since the 1980s, and India grew faster than 92% of the world's nations during 2003-2013.[1] India is now the third-largest economy in the world in terms of purchasing power parity and accounted for almost 6% of global gross domestic product (GDP) in 2013. Real GDP expanded at an average annual rate of 7.2% during FY2008-FY2012, which helped reduce the country's poverty rate from 37.2% in 2000 to 21.9% in 2012.[2] Although India weathered the 2008–2009 global financial and economic crises relatively well, growth has since slowed. This has been due to tighter monetary policy to counter persistently high inflation, the lack of consensus among political parties on some policy and regulatory issues, as well as the adverse effects of a decrease in global demand. India's GDP growth was 6.2% in FY2012 and 5% in FY2013, and the initial government estimate for FY2014 was 4.9%.

2. Despite GDP growth that is below potential, consumer price inflation averaged about 9% between FY2012 and FY2014 due to rising food prices. However, the inflation decelerated sharply in December 2013 due to a drop in food prices, especially for vegetables. During May-August 2013, the Indian rupee lost more than 18% of its value against the United States (US) dollar. This was the result of a $15 billion capital outflow sparked by fears about the tapering of the US Federal Reserve's quantitative easing program. Marked currency depreciation affected import prices, although the effect on final domestic prices has been limited by weak demand, which has curtailed pricing power and forced firms to tighten margins. The foreign exchange rate has been stable since August 2013.

3. The central government deficit for FY2014 has been estimated at 4.6% of GDP, an improvement of 3 percentage points from the previous year and of almost 2 percentage points from the deficit's peak in FY2010.[3] However, the deficit remains well above the 3.4% of GDP average recorded during 2004-2007 after government adoption in 2003 of fiscal responsibility legislation and prior to countercyclical stimulus in response to the 2008–2009 global crisis. The central government's debt-to-GDP ratio was estimated to be 51.5% by the end of FY2014, slightly higher than in FY2013.

4. The government estimates that the current account deficit narrowed sharply to 2.2% of GDP in FY2014 from 4.7% a year earlier.[4] The improvement reflected a large compression of the trade deficit from 10.4% of GDP in FY2013 to 7.9% in FY2014. Imports of oil, the largest item, were stagnant. Those of gold, the second largest, fell by 45.2% from FY2013 as higher taxes and quantitative restrictions on gold import took hold. Despite this, the decline in imports was broad-based, with the economic slowdown hitting imports of such capital goods as machinery and transport equipment. Competitiveness gains from a weaker currency and a pickup in demand in some of the advanced economies helped exports to grow by 4.7% in FY2014.

5. A return to a high-growth trajectory is possible, given India's high potential for long-term growth. The dependency ratio is expected to fall from 55% of the working-age population in 2010 to 47% in 2030, allowing for a higher output per capita. Savings rates are likely to rise as the relative share of the working-age group in the population expands, and this could lead to

[1] World Bank. 2013. *Country Partnership Strategy for India, 2013–2017*. Washington D.C.
[2] Asian Development Bank (ADB). 2013. *Country Partnership Strategy: India, 2013-2017*. Manila.
[3] World Bank (2014). *India: Country Snapshot*. March. Washington D.C.
[4] Asian Development Bank (ADB). 2014. *Asian Development Outlook, 2014*. Manila.

faster capital accumulation. The average amount of schooling people 25 years of age and older have received is expected to increase from 4.4 years in 2010 to 6.0 years in 2030. Total factor productivity grew by around 2.5% per year during 2003-2010 and this rate could increase as markets integrate further and workers shift from low- to high-productivity jobs. While less than 30% of the population lived in cities in 2010, that is expected to climb to 40% in 2030.

6. To achieve India's growth potential, government needs to persist with reforms and resolve some complex policy and regulatory issues. Since FY2013, the government has introduced reforms in diesel pricing, foreign direct investment in the retail sector, and public sector disinvestment plans. These have helped to improve the investment climate. Investor confidence has grown further since a general election in May 2014. The new government's parliamentary majority is expected to enable it to move rapidly on economic reforms it has promised to support GDP growth. According to the Economist Intelligence Unit, India's GDP growth is expected to rebound to an average of 6.4% a year during FY2015-FY2019, driven by private consumption and investment.[5]

7. India is currently rated Baa3 (foreign currency) by Moody's Investor Service, BBB– by both Standard and Poor's and Fitch Ratings, and AAA by Indian rating agencies CRISIL and ICRA.

B. Housing Sector Overview

8. Urbanization has been an engine of growth for India's economy. During 2001–2011, the urban population of India grew at a compound annual growth rate (CAGR) of 2.8%, increasing the level of urbanization from 27.81% to 31.16%. According to the 2011 census, 377 million of India's 1.2 billion people lived in urban areas.[6] By 2025, urban areas are projected to account for 38% of the population.[7] Despite its contribution to growth, rapid urbanization has also led to land and housing shortages, traffic congestion, and stress on such basic infrastructure as water and electricity supply in towns and cities.

9. India suffers from an acute shortage of housing. According to the Ministry of Housing and Urban Poverty Alleviation, the estimated housing shortage in India was 18.78 million units in 2012, and it affected the country's least-well-off socioeconomic groups much more than others. Government agencies estimated that 56.2% of the housing shortage affected households categorized as "economically weaker sections," with annual incomes of Rs100,000 or less. Another 39.4% of those affected were "low-income households," with annual incomes of Rs100,000-Rs200,000.[8] The housing shortage and poor affordability have forced many low-income families to live in cramped, substandard accommodations that have limited access to basic amenities. They often rent rather than own these homes. A large number of other people in these income groups are driven to occupy marginal lands with poor housing stock and no sanitation facilities or to live in urban slums.

[5] Economist Intelligence Unit. 2014. *India Country Forecast, June 2014.* London.
[6] Jones Lang LaSalle. 2012. *Affordable Housing in India: An Inclusive Approach to Sheltering the Bottom of the Pyramid*. Mumbai.
[7] Dobbs, Richard and Shirish Sankhe. 2010. *Comparing urbanization in China and India.* Seoul. http://www.mckinsey.com/insights/urbanization/comparing_urbanization_in_China_and_India
[8] Government of India, Ministry of Housing and Urban Poverty Alleviation (MoHUPA). 2012. *Report of the Technical Group on Urban Housing Shortage (TG-12) (2012-17)*. New Delhi.

10. The construction sector in India has shown increased interest in supplying housing to lower-income customers since 2010. The slowdown of local economies and dampened demand for upscale real estate development have forced developers to focus more on affordable housing. According to Deloitte Touche Tohmatsu, at least 30,500 units priced below Rs1 million came to market in 132 projects in 22 cities during June 2011–January 2013. The potential market for affordable housing is good due to rapid urbanization,[9] rising disposable income, and a preference among those who can afford it for home ownership over renting. A large proportion of low income families in urban areas have a monthly household income of Rs10,000--25,000 and can afford to pay Rs400,000–1,000,000 for privately built formal housing without aid from the government. An estimated need of 15 million homes for these low-income customers translates into a funding need of Rs7 trillion.[10]

11. The government has placed a high priority on developing the housing sector and has increasingly recognized the role the private sector can play in addressing the housing needs of lower-income customers. Government entities at the central, state, and local levels have provided incentives for the private sector to build housing for the urban low income families. The government supply-side interventions have included providing subsidies for construction of low cost affordable housing (LCAH), providing fast approvals of LCAH projects, and earmarking land for LCAH for low-income groups. On the demand side, the government has also provided support for prospective buyers, including interest rate subsidies, the reduction of stamp duties and registration fees, and income tax exemption on the housing loan interest repayment of up to Rs0.2 million.

C. Housing Finance Sector Overview

12. India's finance sector remains underdeveloped, with banks still dominant. This makes access to finance a large problem for the 60% of country's people who do not have a bank account.[11] At the end of FY2012, the total assets of all scheduled commercial banks stood at $1.5 trillion, and total equity was $111.7 billion. This indicated a system-wide leverage ratio of 7.3%. Public sector banks, which account for 76% of the banking sector assets, face tighter capital constraints, with a leverage ratio of 5.9%. Total loans extended by the banking sector amounted to $931.4 billion in FY2012, equivalent to 51% of GDP, a low level compared with some other countries in the world. Despite good growth rates of 19% per year during FY2009-FY2013, India's housing finance market is underdeveloped. It had a very low mortgage penetration rate of 7.6% at the end of FY2013,[12] compared with rates of 20% in the People's Republic of China and 81% in the United States, for instance.

13. Commercial banks have traditionally focused on working capital and short-term lending. While some have become active in mortgage lending, they play a much smaller role overall in the housing finance market than do their counterparts in other countries. India also differs in the fact that housing finance companies (HFCs) also play a significant role in the housing finance market. The HFCs have had strong growth due to their strategic approach, targeting of special customer segments, and customer service that is superior to commercial banks. The largest

[9] According to the United Nations, India's urban population is forecast to expand at a CAGR of 2.4% from 2010 to 2030, when it will reach 590 million. United Nations. 2014. *World Population Prospects.* New York.

[10] Deloitte Touche Tohmatsu India. 2013. *State of the Low-Income Housing Market: Encouraging Progress & Opportunities to Realize Dreams of Millions*. July 2013. Mumbai.

[11] Government of India, Reserve Bank of India. 2013. *Committee on Comprehensive Financial Services for Small Businesses and Low Income Households Report.* Mumbai.

[12] Measured by the total mortgage loans–GDP ratio. ICRA. 2013. *Indian Mortgage Finance Market Update for H1, FY2014.* New Delhi.

HFCs include HDFC, Dewan Housing Finance Corporation, GRUH Finance, Indiabulls Housing Finance, Reliance Housing Finance, Sundaram BNP Paribas, and PNB Housing Finance. As of 31 March 2013, 56 HFCs were registered with the National Housing Bank, of which 18 were permitted to accept public deposits, 48 were public limited companies, and 8 were private limited companies. They had a total of 2,065 branches and other offices across the country.[13] At the end of FY2013, their total outstanding loan portfolio stood at $71.6 billion, indicating a CAGR of 25.5% from FY2011. Total equity was $9.4 billion, representing a CAGR of 24.9% during FY2011-FY2013. The system-wide gross nonperforming asset (NPA) ratio was 1.11%, and the net NPA ratio was 0.45% at the end of FY2013. Both had shown consistent improvement during FY2011-FY2013 and were stronger than the average gross NPA ratio of the banking sector of 3.1%.

14. The number of HFCs, their geographic coverage, and their loan portfolios have been growing since 2010. The share of HFCs in the total housing loan portfolio increased from 41% in FY2010 to 46% in FY2013. Compared with commercial banks, HFCs focus more on lower-value and higher-volume lending segments. Many HFCs have also started offering new products to the low income customer market, including loans for developer-built housing, incremental housing, new projects, and resale properties. When lending to the informal sector without formal documentation, HFCs typically use a field-based credit assessment process, leading to higher operating costs. HFCs also generally have higher costs of funding. Despite facing significant funding constraints and the challenges of a higher cost base, most HFCs expect continued healthy growth due to the huge market potential.

[13] National Housing Bank (2013). *Report on Trend and Progress of Housing in India.* New Delhi.