

RISKS TO WATCH

INDIA

India's government is bogged down trying to defend itself in a slew of corruption scandals that has deadlocked parliament, as political firefighting saps the coalition government's ability to enact financial reforms.

CORRUPTION SCANDALS

The opposition has forced parliament to shut for around two weeks, demanding a joint probe into an alleged **telecoms scandal that may have cost India \$39 billion in potential revenue loss**. A **separate bribes-for-loans scandal which has the potential to disturb India's banking sector** is also unfolding.

For foreign investors in India, most of whom are well aware that corruption is not a new problem, the major concern is that the deadlock in parliament persists, stalling longer-term financial reforms. If the next session has to deal with matters delayed from this term, debate of some key bills will be pushed back.

That could include landmark investor-friendly goods and services tax (GST) legislation – intended to unify a fragmented tax system – and other tax laws. GST may not be passed until after September 2011. Other reforms such as **opening the retail sector, keenly awaited by foreign firms such as Wal-Mart**, can in theory be enacted by an executive decision, but in practice are politically sensitive and are unlikely to be pushed through without a parliament debate.

Although there is no threat to the stability of the Congress party-led coalition government, the scandals have eroded its political capital since an impressive election victory last year, and become **a test of how Prime Minister Manmohan Singh tackles corruption**. If the Congress party is to pay a political penalty, it will not be immediate. Around half a dozen state elections are scheduled over the coming year, but the next national poll is not slated until 2014.

Another potential risk to investments could come from an increasingly assertive environment ministry which is unafraid of running up against big business as it tries to enforce green laws. Investments worth tens of billions of dollars are up for review, including a proposed \$12 billion steel project by **South Korea's POSCO**.

What to watch:

- Progress of legislation on nationwide goods and services tax.
- Announcement of further sales of stakes in state firms to raise \$8.64 billion to help cut the fiscal deficit.
- Whether the opposition changes its stance of rejecting Congress' suggestion of a probe monitored by the Supreme Court as a way to end the impasse.
- Any change in the opposition's strategy as a result of its own corruption problems in southern state Karnataka, where it heads the government.
- What happens next to POSCO's planned steel mill.



Kritivas Mukherjee
Political and General News Correspondent
New Delhi

kritivas.mukherjee@thomsonreuters.com
+91 11 4178 1008



INFLATION AND MONETARY POLICY

Even before the corruptions scandals, the government had been distracted from reforms by fighting stubbornly high inflation since its reelection last year.

India's annual headline inflation eased slightly in October to a 10 month low, but at 8.58 percent was still above the central bank's comfort zone.

Growth in industrial output has eased more than expected for two consecutive months. This has fed speculation that the Reserve Bank of India will hold rates steady in the near term, although some analysts still expect at least a 25 basis points increase by the end of the fiscal year 2010/11. RBI's next policy meeting is on Dec 16.

One key risk India faces is **a torrent of capital inflows from the quantitative easing by the U.S. Federal Reserve**. India has not imposed capital controls as it needs capital inflows to bridge the near 3 percent current account deficit.

Another rate increase may trigger a fresh wave of capital inflows, complicating monetary policymaking at a time of high inflation.

Men daubed in colours celebrate the re-enactment of a local tradition of "Lathmar Holi", also known as the festival of colours, celebrated at Barsana in the northern Indian state of Uttar Pradesh.
REUTERS/K. K. Arora

RISK DATA

Sovereign foreign currency:
S&P BBB- (stable)
Moody's Baa3 (stable)
Fitch BBB- (stable)

World Governance Indicators:
Voice & Accountability 60.2
Political Stability 13.2
Govt Effectiveness 54.3
Regulatory Quality 44.3
Rule of Law 55.7
Control of Corruption 46.7

Eurasia Group
GPRI score 61

IHS Global Insight
Country risk 2.73
Sovereign BBB (positive)

Economist Intelligence Unit
Sovereign risk BB
Political risk BBB
Country risk BB

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KEY DATES

- **December 16, 2010**
Reserve Bank of India monetary policy review
- **December 2010**
Chinese Premier Wen Jiabao visits India
- **February 28, 2011**
Q4 2010 GDP date due
- **2014**
Deadline for next general election to be held

What to watch:

- July-September quarter GDP data. This will influence any RBI decision on rates. Finance Secretary Ashok Chawla has said he expects it to be close to the 8.8 percent recorded in the April-June period.
- RBI policy review on Dec. 16. Comments by policymakers, advisers and central bankers on the outlook for inflation. Hawkish comments raise the likelihood of bigger rate increases and would weigh on bond prices. After the fuel price hike, any signs the government will fast-track other reforms will be bullish for markets.

SECURITY

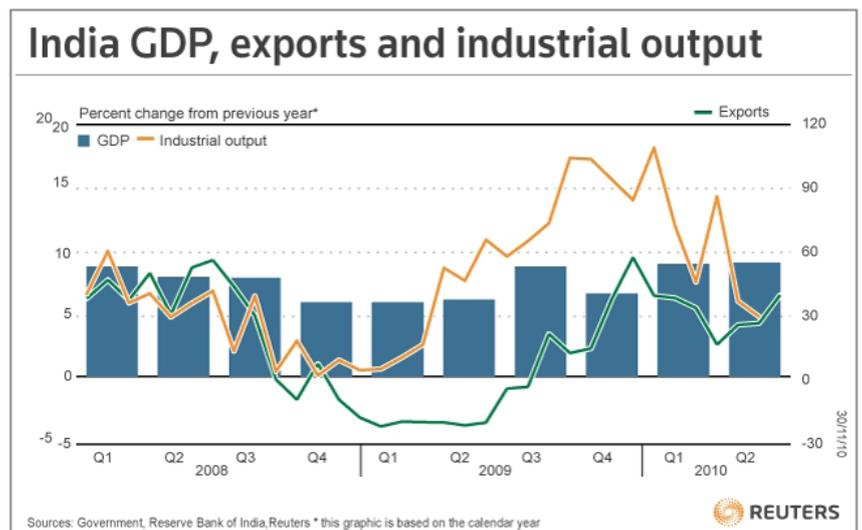
Threat levels in India remain relatively high ahead of scheduled visits by leaders from France, China and Russia in December. Indian officials say Kashmiri separatist militants might try to stage "spectacular" attacks to draw attention to a region that is at the heart of the dispute between India and Pakistan and caused two of their three wars.

Another attack like the 2008 militant strike in Mumbai that killed 166 people which India blamed on Pakistan-based militants would raise the risk of an Indian retaliation.

The risk from Maoist rebels in India's heartland remains unchanged even though the government has stepped up its offensive against them.

What to watch:

- The danger of militant attacks. Markets have proven highly resilient to terrorism -- the impact was very limited even when gunmen rampaged through Mumbai in 2008. But an attack which sharply raised the prospects of conflict with Pakistan would have a strongly negative impact on asset prices, particularly in the current risk-averse climate in global markets.
- The government has stepped up its offensive against the Maoists but the risk of more attacks, especially on targets with economic importance, has risen.



Sources: Government, Reserve Bank of India, Reuters * this graphic is based on the calendar year
Reuters graphic/Catherine Trevethan

RISK DATA

JLT Group	
Strikes, riots & civil unrest	6
Terrorism	7
War & civil war	4
Economic risk	6
Currency risk	5
Sovereign risk	5
Expropriation	4
Contract repudiation risk	6
Legal & regulatory risk	6
Coface	
Country rating	A3
Business climate	A4
Transparency International	
Corruption Perceptions Index Score	3.4
Rank (of 180)	84
World Bank Doing Business	
Rank (of 183)	133
WEF Global Competitiveness	
Score	4.33
Rank (of 133)	51
Reporters Sans Frontières	
World Press Freedom Index Score	38.75
Rank (of 175)	122