Monthly Economic Report September 2014

British High Commission New Delhi

- Growth recovery uneven.
- Inflation pressures seen abating, but the RBI still on guard.
- External sector in good shape.

Growth recovery uneven

While India's GDP in Q1 FY15 rebounded to a stellar 6% (y/y) growth led by industrial and services sector; monthly indicators suggest that the pace of the recovery is uneven.

For instance the manufacturing Purchasing Managers Index (PMI), which is considered a forward looking sentiment indicator eased to 51 in September 2014 from 52.4 in August and 53 in July (a reading above 50 indicates likelihood of expansion). Echoing this, industrial production growth remained stagnant at 0.4% (y/y) in August (from almost 4% in June and 5% in May), driven by disappointing performace of the capital goods sector. Credit growth in September fell below 10%, a 5 year low; although bankers expect a revival in the next half of the year.

Standard and Poor's is finally optimistic!

Standard and Poor's raised the outlook for India's BBB (minus) rating to "stable" from "negative," saying the country's government mandate and improved political setting offers a conducive environment for reforms.

S&P was the last of the three main global ratings agencies with a negative outlook on India. While Moody's had kept their outlook unchanged, while Fitch had upgraded it to stable in 2013.

In April 2012, S&P had lowered India's rating outlook to negative, accentuating chances of a downgrade. This could have prompted foreign investors to pull out of the country and pushed up borrowing costs for Indian companies.

The revision in outlook is undoubtedly a welcome step and should bode well for foreign inflows. The political set up is more stable, inflation is coming down, and the external sector has corrected in a significant way. But it is still a long way for a rating upgrade for India as some clarity is still required on fiscal consolidation; take-off pace of the reform agenda and sustained pick-up in growth in a controlled inflationary environment.

On the flip side, new investment projects announced rose to 7.3% of GDP in Q2 FY15, the highest level in nine quarters. Although much lesser than the peak of over 30% of GDP prior to the global crisis; the current pick-up comes after a long period of stagnation. Most of these new investments are in the power, shipping and road sectors. The core infrastructure sector index grew by almost 6% (y/y) in August, more than double the pace registered in the previous month; driven by coal, electricity and steel sectors. Other indicators such as railway freight, aviation passenger traffic, auto data, imports and diesel consumption also indicate that there is some momentum picking up in domestic demand.

Inflation: Abating but RBI still on guard

Inflationary pressures seem to be easing. The Wholesale Price Index (WPI) touched a five year low of 3.7% (y/y) in August compared to 5.2% in the previous month. Core-WPI (manufactured products) has already been trending low for a while now. Vegetable and protein inflation (egg, meat, fish) have seen

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record contraction on a year-on-year basis. Fuel inflation eased to 5-year low of 4.5% due to decline in the price of the non-administered month.

In its recent policy meet, the RBI left policy rates unchanged at an elevated 8% although the messaging suggests that it is more optimistic on inflation now than it was earlier. **RBI reiterated its projection of 5.5% GDP growth in FY15 and 6% in FY16, and CPI inflation of 6% by Jan 2016**.

External sector macroeconomics stable

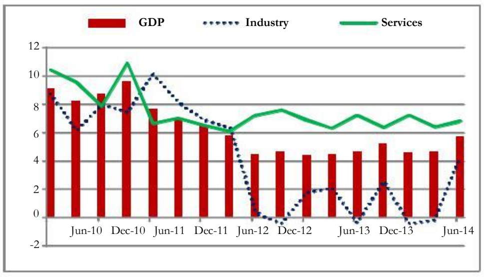
Current account deficit stands at 1.7% of GDP as of Q1 FY13; increasing from 0.3% in the previous quarter, but very much in stable territory. The widening comes primarily from increase in non-gold imports, which is an indicator of improving domestic demand. Export growth improved to 10.6% (y/y) compared to -1.3% in the previous quarter. On the capital account, net inflows rose sharply to 4.2% of GDP from 1.8% in Q1, part reflecting the higher portfolio and FDI flows that came with the new government. Adequate capital flows ensures that the current account deficit is sustainable.

An improvement in growth, and easing of gold import restrictions could increase imports going forward. However this should also lead to higher foreign flows which will stem the gap. Worryingly, recent data on exports suggest that weaker than expected global demand is denting its growth. Exports growth in August fell to a 5 month low of 2.3% (y/y) compared to 10%-plus growth rates in May and June and 7% in July.

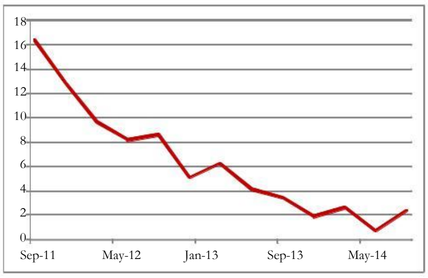
Our previous reports are accessible here.

GROWTH: *Industrial growth slips to 4-month low of 0.5% in July*

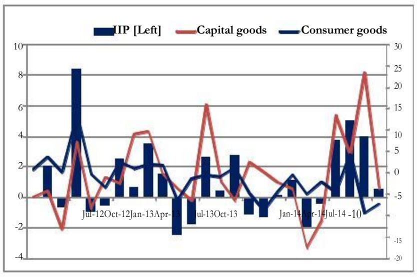
GDP



Projects Under Implementation

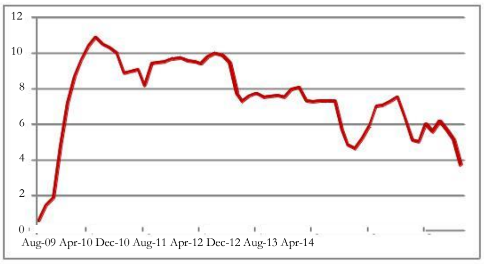


IIP/Capital/Consumer Goods

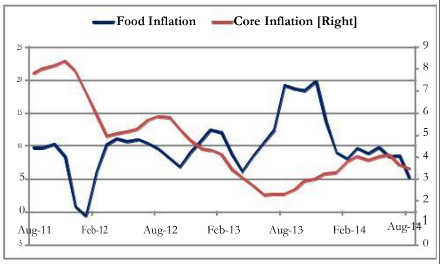


INFLATION: *August WPI inflation eases to near five-year low of 3.7%*

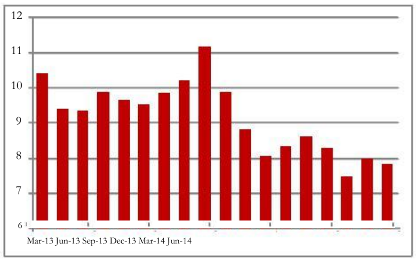
Wholesale Price Index (% y/y)



Food vs. Core Inflation (% y/y)

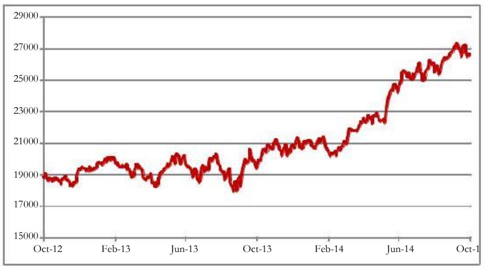


Consumer Price Index (% y/y)

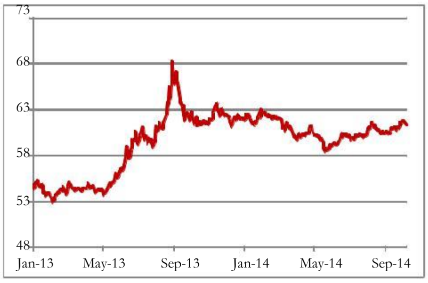


MARKETS: *Rupee remains range-bound*

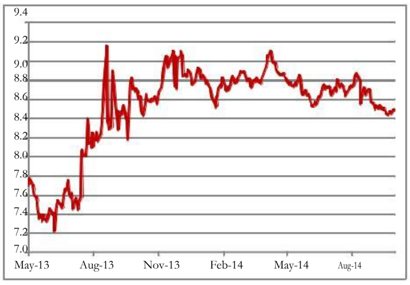
SENSEX



USD/INR

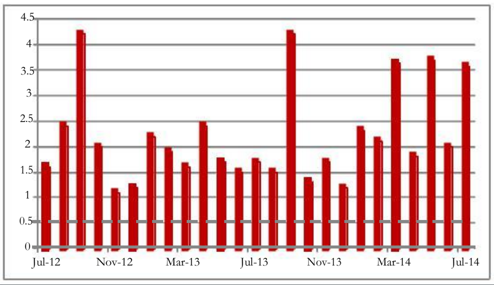


10yr Govt. Securities yield (%)

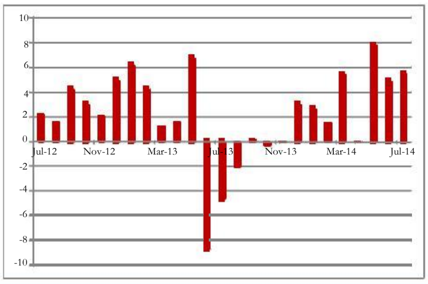


EXTERNAL: *Current account deficit narrows to 1.7% of GDP in Q1 2014-15*

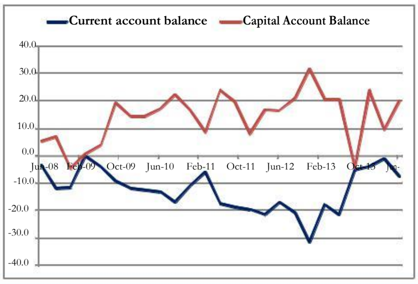
FDI ($ Bn)



FII ($ Bn)

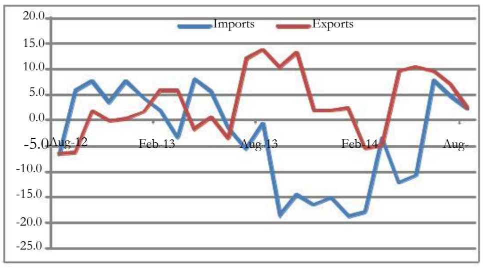


Current vs. Capital A/c ($ Bn)

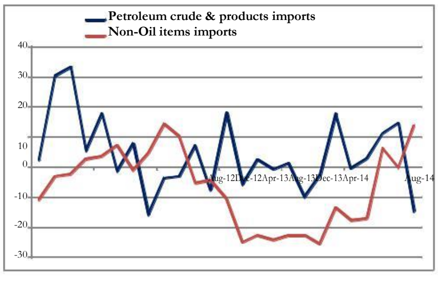


TRADE: *Exports growth slip to 5-month low of 2.4% in August; trade deficit at 4-month high*

Export/Import Growth (% y/y)



Imports- Oil and Non Oil (% y/y)



Trade Balance ($ Bn)