SUMMARY

- Growth at 7.3% in 2014-15 but major indicators remain sluggish
- Modi's tour of China, Mongolia and South Korea -economic and trade cooperation high on the agenda
- India and the AIIB- benefits and challenges

IS THE ECONOMY RECOVERING?

The Indian economy grew at 7.3% in the last fiscal year as economic activity expanded at a faster clip in the March quarter, led largely by the services and manufacturing sectors.

Although the provisional estimates for the fourth quarter peg India's growth at 7.5%, compared to China's 7%, doubts linger over the accuracy of the new technique being followed by the Central Statistics Office, especially after a sharp revision in the December quarter numbers from 7.5% to 6.6%. Even the Chief Economic Adviser to the Finance Minister called the new series of GDP data puzzling.

The government, however, cheered the numbers, with finance minister Arun Jaitley saying the economy is in "recovery mode".

Gross value added (GVA) for the manufacturing sector rose 7.1% in FY15 compared with 5.3% in the previous year, giving a timely boost to the government's `Make in India' plan.

AN INDIAN LENS ON THE AIIB

India is the second biggest stakeholder in the 57-nation Asian Infrastructure Investment Bank (AIIB). China, which sponsored the bank, will have 30.9% share followed by India with 10.9%. At a juncture when infrastructure growth has been put at the centre of the economic revival project, increased international lending capacity will reflect positively for India.

One of the reasons India has embraced the AIIB is the fact that it hopes to receive development finance for coal-powered electricity generation. The Indian government would like to increase renewable energy capacity, but it has reiterated that, to meet the country's development needs, coal-fired power generation will have to be significantly stepped up. The AIIB may have a significant impact on the energy choices available, by avoiding constraints on how the World Bank lends. In 2013 the US placed restrictions on financing coal-fired electricity generation abroad for climate change reasons. The World Bank's policy, in keeping with that of the US, is only to lend for coal-fired electricity projects in rare circumstances.

One point of concern is agriculture, which was hit by a deficient monsoon last year and unseasonal rainfall that damaged standing crops this year. During the fiscal year, agricultural growth almost vanished; it slowed to 0.2% from 3.7% a year ago.

However investment, credit growth and the job market are some of the major indicators of broader growth in the economy which are still sluggish. External and domestic demand remains weak. The government's fiscal ability to create demand is reducing. So, driving up demand is the biggest challenge.

INFLATION SOFTENS

Consumer price inflation eased to 4.9% in April 2015 from 5.3% in the previous month. Particularly striking was the fact that food inflation came in over a percentage point below the March number. In light of concerns about the impact of weather-related shocks to agricultural production, the steady moderation of food inflation suggests that supply disruptions were not as large as feared. The Wholesale Price Index (WPI) also dropped to a new low of (-) 2.7% in April, mainly on account of the decline in prices of fuel and manufactured items. It has been negative since November 2014.

BUT INDUSTRIAL OUTPUT SLOWS

In contrast, industrial production grew by a rather sluggish 2.1% yoy, a sharp decline from 5% in the previous month. Manufacturing, the government's focus area, was the main cause, growing by 2.2% in March, and a pallid 2.3% overall in 2014-15. Looking beneath the aggregates, the performance of various categories of industrial goods also suggests that several key industries are yet to enter recovery. While fluctuation is inherent in the way capital goods output growth is measured, sustainable and healthy growth in consumer goods is required for a broad-based demand recovery.

THE RBI CUTS RATES FOR THE THIRD TIME TO SPUR INVESTMENT AND GROWTH

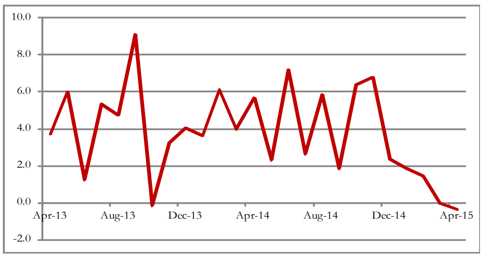
The RBI cut interest rates for a third time this year, to lend more support to an economy that the bank itself says is not doing as well as latest impressive growth numbers suggest. RBI cut the repo rate (short-term lending rate) from 7.5% to 7.25%, but left all other policy tools like cash reserve requirement unchanged at 4% and Statutory Liquidity Ratio (SLR) at 21.5%. Despite demands from India's commercial banks, the RBI did not take steps to free up liquidity, which bankers had said were needed for them to lower lending rates and pass on the benefits of monetary easing to the broader economy. Instead, with growth in bank lending at its lowest in almost two decades, the RBI urged banks to reduce rates quickly.

MODI'S PURSUIT OF 'ACT EAST' POLICY

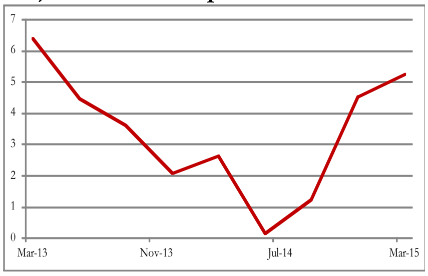
Modi visited China, Mongolia and South Korea. He held wide-ranging talks and wooed investors for his "Make in India" campaign. Indian and Chinese firms signed agreements worth more than $22bn in areas ranging from telecom to steel, solar energy and films. The two countries have also agreed to set up a high level task force to look into ways to address India's concerns over its widening trade deficit which touched $48bn in 2014-15. South Korea offered $10bn to India for infrastructure, development of smart cities, railways, power generation and other areas. On the other hand, India announced a $1bn credit line to Mongolia for infrastructure development and agreed to deepen defence cooperation besides exploring the potential for collaboration in areas like the civil nuclear sector.

GROWTH: *IIP at five month low on manufacturing woes*

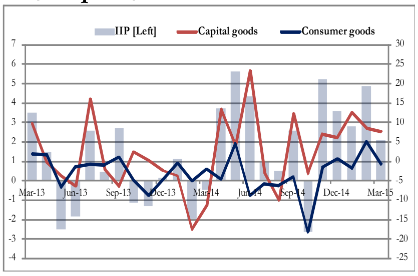
Core Infrastructure Industries



Projects Under Implementation

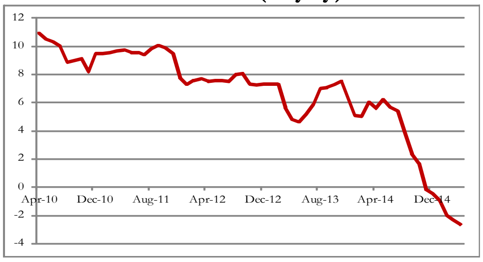


IIP/Capital/Consumer Goods

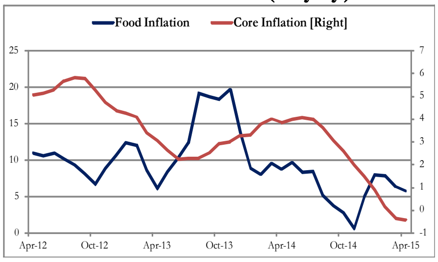


INFLATION: *WPI inflation contracts for a sixth month to -2.7% in April*

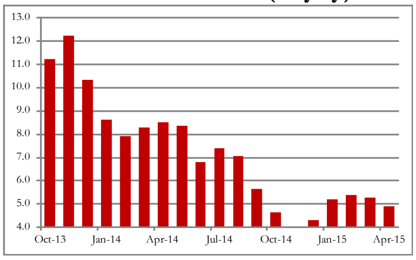
Wholesale Price Index (% y/y)



Food vs. Core Inflation (% y/y)

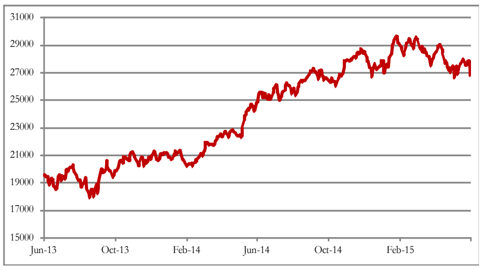


Consumer Price Index (% y/y)



MARKETS: *Rupee remain range-bound*

SENSEX

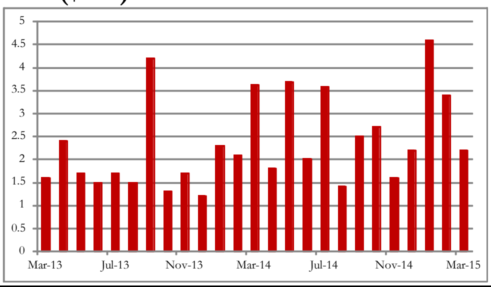


USD/INR

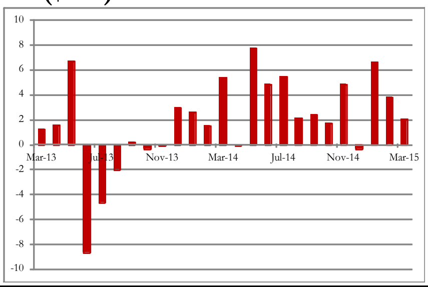
10yr Govt. Securities yield (%)

EXTERNAL: *FDI falls to $2.2bn in March*

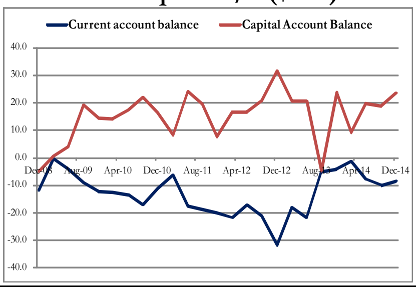
FDI ($ Bn)



FII ($ Bn)

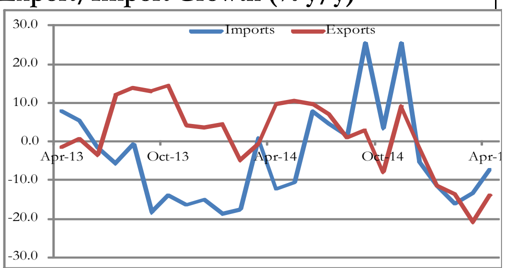


Current vs. Capital A/c ($ Bn)

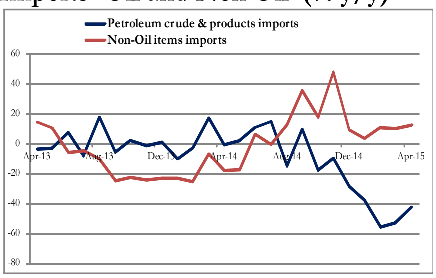


TRADE: *Exports fall 14% in April on muted global demand*

Export/Import Growth (% y/y)



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



Trade Balance ($ Bn)