SUMMARY

- GDP grows 7% in Q1 FY16
- Inflation moderates further.
- Special feature on RBI's policy drivers.

GDP – A QUANDARY

GDP at market price fell to 7% (y/y) in Q1 FY16 compared to 7.5% in the previous quarter.

GDP at gross value added rose to 7.1% from 6.1% previous quarter.

What do these figures imply?

'Gross value added' GDP is a sectoral break-up of the economy – agriculture, industry and services. Industry growth picked up from 5.6% in the previous quarter to 6.5% with manufacturing growing by a healthy 7.2%. Electricity GDP however looks worrying - after growing at 9-10% last year, it has slowed to just over 3% presently. This could reflect conditions in state electricity boards and divergence between capacity and generation. Agricultural growth rose despite poor monsoons – although this could be revised as crop data trickle in. Services growth, as always, remained a healthy near 9%. Within services, 'Trade, Hotels, Transport and Communication' clocked a stellar 13% (after averaging 11% last year), indicating that the Indian consumer's appetite remains strong.

The 'market price' GDP is the sum of consumption, investment, government spending and net exports. Private consumption growth has slowed a bit from the previous quarter, but remains at a healthy 7.4%. Fixed investments, chief cause of India's slowdown in recent years, grew by 5% - up from 3% in the previous six months, but still far below pre-slowdown levels of over 16%. The chief reason for this protracted slump has been the lack of any significant revival in private capital expenditure.

CAN THE RBI RELAX?

Rajan's move to the RBI was accompanied by rock-star hype in the media and currency markets. As fears bubble in global markets of a China slowdown, the RBI has maintained policy poise. Rajan's two years in office have seen inflation come down, monetary policy shift to inflation targeting, innovations in the banking sector, and stable currency markets.

However, the RBI faces a curious policy dilemma. Growth has been supported by government spending. On the other hand, consumer inflation has sharply fallen and wholesale inflation is in negative territory, adding a new word to India's economic vocabulary – deflation! Yet policy rates remain elevated, with the RBI cutting them by only 75 bps from record highs after the global financial crisis. The clamour for lower rates is increasingly vocal.

Onions may determine the flavour of Rajan's response. Despite inflation falling, concerns over poor monsoons have caused a sharp hike in prices. As a staple food, this has a strong impact on sentiment. The latest monetary policy review suggests that the RBI is far from convinced that inflation has eased for good. Rajan has often stated that inflation for the common man remains high and cutting interest rates to satiate the market is policy myopia. The RBI is also pushing banks to transmit its rate cuts through cuts in their own interest rates.

Impending monetary tightening in the US and the Chinese slowdown are also on the RBI's radar. While it has adequate forex reserves to support intervention, Rajan will be well aware that poorly received interventions can badly backfire.

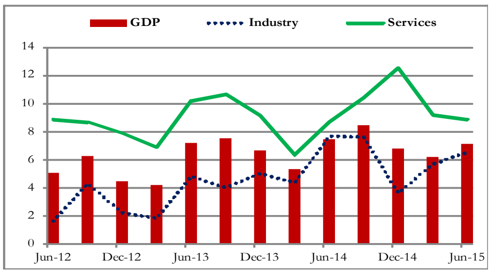
So India's key growth driver remains the government. Fiscal statistics show that between April and July, the government already reached 70% of its fiscal deficit target for the year – driven primarily by a 38% (y/y) growth in capital spending. Much of this money has been channelled to roads and railways. This is a change in fiscal mathematics, since successive Finance Ministers, have managed the fiscal deficit figure by sharply cutting down on capex in the last few months of the fiscal year. This time may be different – the fall in global crude oil prices (hence a reduced subsidy burden) and a rise in tax collections imply that the government is in a better position to lower revenue expenditure and improve the quality of fiscal consolidation.

INFLATION – THE COOLING CONTINUES

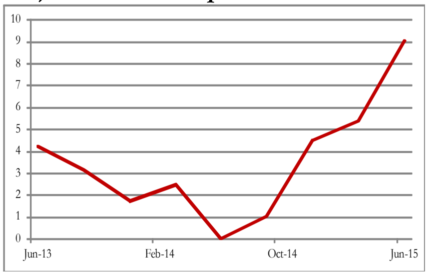
Consumer inflation has slipped to an 8-month low of 3.8% (y/y) in July 2015 compared to 5.4% in June. Food inflation fell to 2.9% from 5.7%. The statistics reflect the government's actions to manage food supplies, and keep increases in minimum support prices moderate. However, we now move into the most difficult season for food price spikes and some core items, for example onions, are already showing signs of stress. Core inflation also cooled off to 4.2% from 4.8%. This is primarily attributable to a fall in services inflation – in particular, transport services, where inflation slipped back into negative territory given benign global crude prices.

GROWTH: *Industrial production growth picks up*

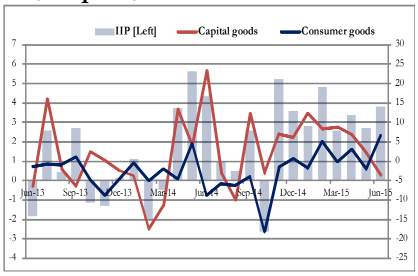
GDP



Projects Under Implementation

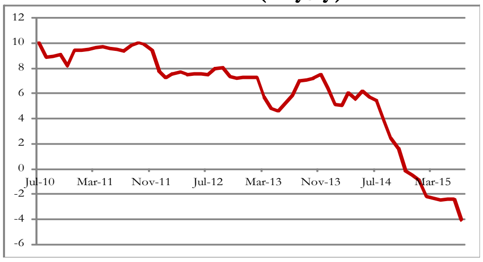


IIP/Capital/Consumer Goods

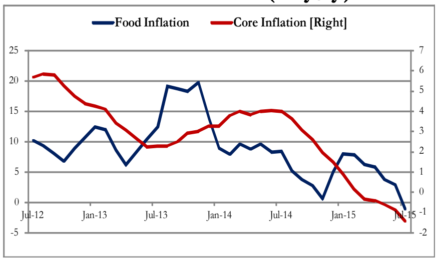


INFLATION: *Wholesale and retail inflation drop sharply*

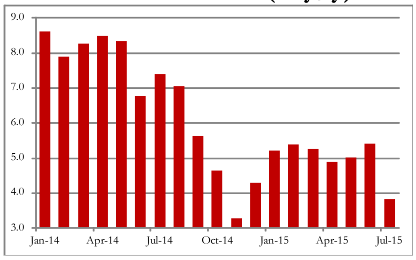
Wholesale Price Index (% y/y)



Food vs. Core Inflation (% y/y)

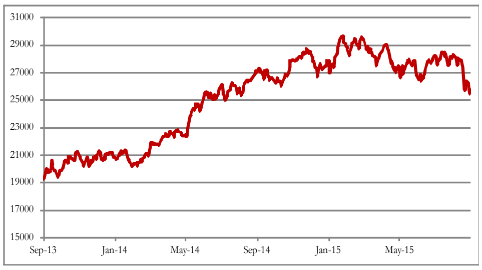


Consumer Price Index (% y/y)

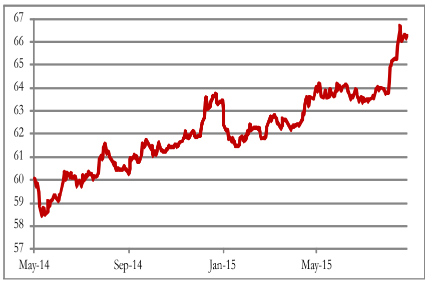


MARKETS: *Volatility due to disturbances in Chinese markets*

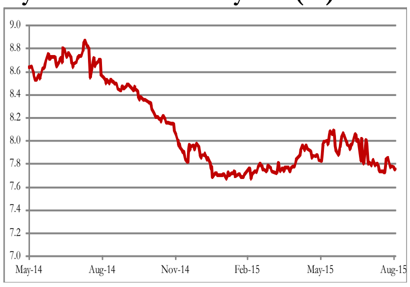
SENSEX



USD/INR

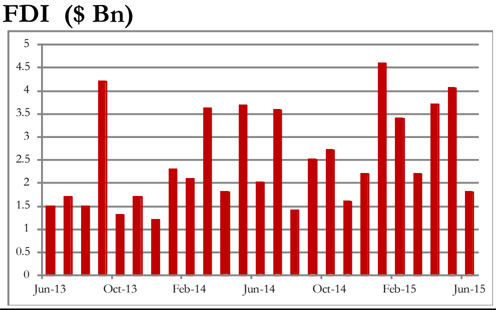


10yr Govt. Securities yield (%)

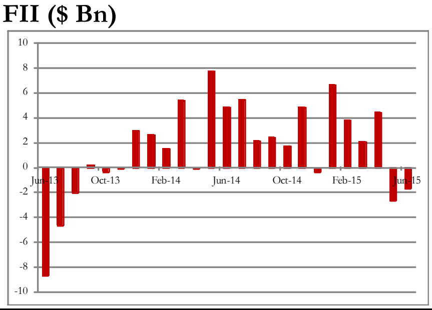


EXTERNAL: *FIIs have fallen sharply in response to high risk aversion in global markets.*

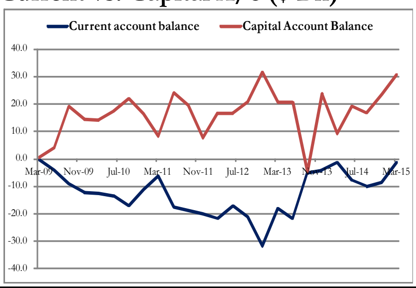
FDI ($ Bn)



FII ($ Bn)

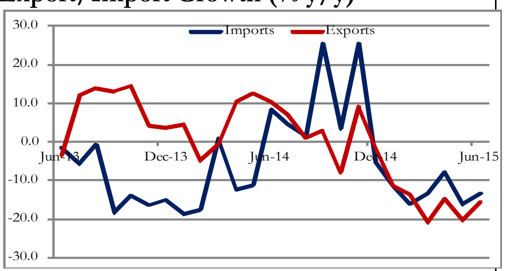


Current vs. Capital A/c ($ Bn)

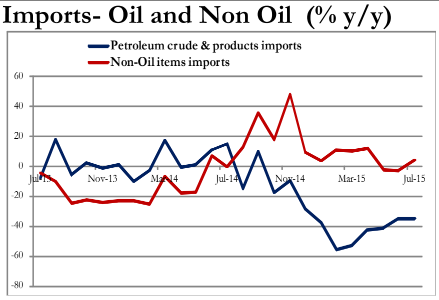


TRADE: *Low commodity prices and sluggish global economy affects both exports and imports.*

Export/Import Growth (% y/y)



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



Trade Balance ($ Bn)