

Summary

- Industrial production growth slows.
- El-Nino effect threatens drought situation in India next year.
- Special feature on RBI's new bank licenses' drive.

Growth Indicators:

The Index of Industrial Production growth contracted by 2% (y/y) in Feb 2014; the weakest reading in the past nine months, driven by a slump in manufacturing and mining. The poor investment climate is evidenced by the continued contraction in capital goods, while the adverse effect of high interest rates and poor consumer sentiment is visible by a contraction in consumer durables of over 9%.

The other leading indicator, an index for eight 'core' infrastructure industries - coal, crude oil, natural gas, refinery products, fertilisers, steel, cement and electricity posted lukewarm performance in 2013-14.

Their aggregate output grew by a mere 2.6% (y/y) in Mar 2014, as compared to the 6.5% growth clocked in Mar last year. Overall in the year, crude oil and natural gas have performed exceptionally badly, reflecting concerns of falling production from the KG basin and impending policy issues in the sectors. Poor investment activity fed into poor performance of cement and steel sectors; although steel production has been better off (4% growth) due to import substitution owing to high global prices and exchange rate volatility (steel imports have contracted by 31%).

The one surprising statistic throughout the year has been the electricity sector; that has outperformed previous year's growth.

A general industrial slowdown should imply lower demand for electricity, so it is possible that robust consumer demand is contributing to the trend. On the supply side, a further breakdown of the subsectors indicates that hydro power generation has jumped up by close to 18.6% this year; primarily owing to a good monsoons leading to higher water levels in reservoirs. Thermal (around 60% of India's power capacity) and nuclear power segments witnessed around 4% rise in generation in 2013-14. While coal based generation has increased; problems in the natural gas sector has dragged down production in gas based plants. One of the factors contributing to below target growth of nuclear power generation is the delay in commissioning of the Kudankulam atomic power project.

New forays in bank licensing

India has come a long way since the first wave of privatisation of the banking sector in the mid-1990s when ten players were allowed. However the third round of private licensing had been pending since 2010. In February 2013, the central bank announced new norms for bank licences, making India one of the few countries to allow industrial houses to establish banks and inviting applications.

In response, twenty six applications were submitted (two later withdrew). While the RBI has been cautious about allowing entry to corporate houses into banking, it has recently issued 'in-principle approval' to two financial institutions – an infrastructure finance company and a microfinance firm.

The RBI governor assured remaining aspirants that they can consider applying for a differentiated permit instead of a full licence. Currently the RBI issues universal banking licences to both domestic as well as foreign banks. Unlike a universal banking licence which is a blanket licence that allows banks to offer a range of services, a differentiated license from the RBI will allow a bank to offer specialised services in select sectors – such as project financing, mortgage banking, industrial financing etc.

The idea of differentiated licences was first proposed in 2007. However this proposal was shelved until a certain degree of success in financial inclusion was achieved and risk management systems of banks were strengthened.

The thinking at the RBI has since changed and the idea of differentiated bank licences was reinvigorated in 2013. Several foreign banks have expressed interest, but it remains unclear whether foreign banks have to set up as a subsidiary to avail of a differentiated license.

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El-Nino effect:

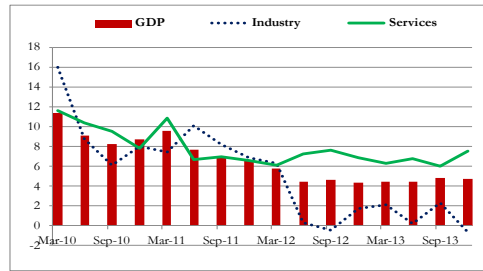
El Nino is an irregular weather phenomenon, occurring every 3-5 years, triggered by above average surface temperatures in the Pacific Ocean. For the Indian subcontinent, El Nino is generally associated with a poor monsoon or drought like conditions, which could potentially lead to fall in crop production. However it is important to note that not all El-Nino years result in droughts. India's meteorological department has forecasted a 60% probability of an El-Nino occurrence with expectation of a below average monsoon. El-Nino generally affects summer crops like rice, sugarcane, cotton and oil seeds. As a rule of thumb, a poor monsoon leads to agriculture GDP growing at below 1% (as opposed to over 3% in years of good rainfall), and agriculture amounts to roughly 15% of the total GDP. This slowdown can also have knock-on effect on non-agricultural sectors through depressed consumer demand, as well as aggravate inflationary pressures.

Our previous report accessible [here](#), and archives [here](#).

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GROWTH: Feb IIP contracts 1.9% on dip in manufacturing, capital and consumer goods

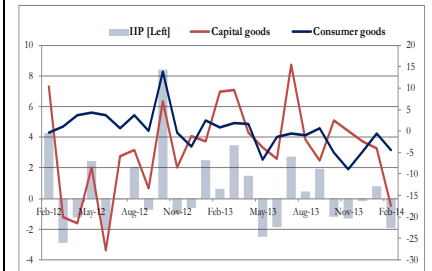
GDP



Projects Under Implementation



IIP/Capital/Consumer Goods

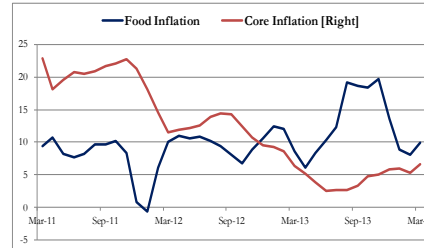


INFLATION: Costlier food items push inflation up in March

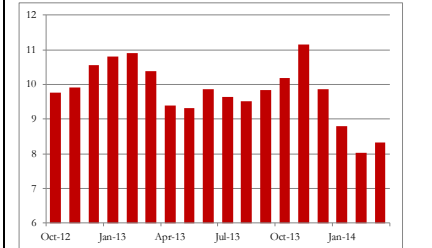
Wholesale Price Index (% y/y)



Food vs. Core Inflation (% y/y)



Consumer Price Index (% y/y)



MARKETS: Stock markets performing strongly

SENSEX



USD/INR

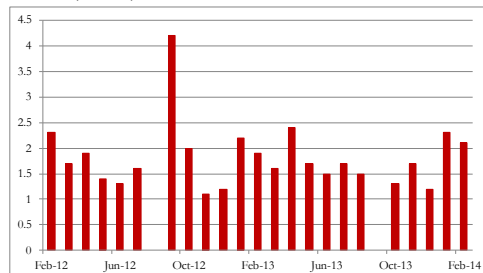


10yr Govt. Securities yield (%)

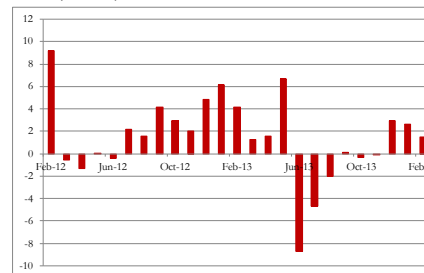


EXTERNAL: FIIs drop to \$1.5bn in Feb 2014

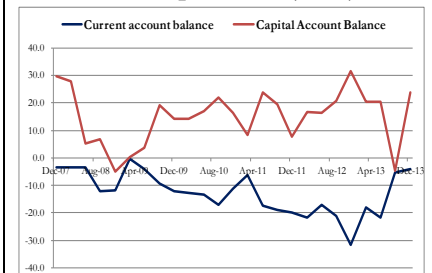
FDI (\$ Bn)



FII (\$ Bn)

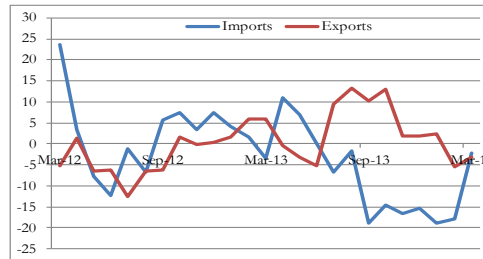


Current vs. Capital A/c (\$ Bn)

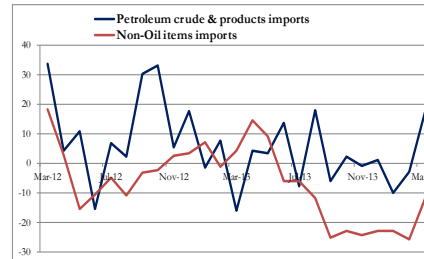


TRADE: Exports contracted for the second month in March

Export/Import Growth (% y/y)



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



Trade Balance (\$ Bn)

