SUMMARY

- Seventh Pay Commission – The Hike and Effect
- June Manufacturing PMI hits three-month high
- Retail Inflation remains flat at 22-month high
- Model GST Law – Insights of the new taxation regime

Seventh Pay Commission – The Hike and Effect

The Cabinet recently approved the recommendations of the Seventh Pay Commission Report – commission that was appointed in February 2014 by previous UPA Government. The recommendations of the report this year will benefit about 10.4mn government employees with salaries ranging from £180 to £2,200 per month. These will come into effect from January 2016 and are expected to have a significant impact on the overall macroeconomic parameters, such as the GDP, fiscal deficit, and inflation.

The government will be spending an additional £9.6bn on pay and pensions in FY17 which is likely to impact GDP by 0.65%. However the pay rise of an average of 23.5% is the lowest hike in 70 years. This compares with the 35% salary hike central government employees got on implementation of the previous pay commission in 2006. Though the salary hike will be implemented from August, the government has deferred the allowances for another four months, which would be implemented prospectively.

Over the course of the current financial year, the salary hikes are expected to boost sales of affordable homes and consumer durables, which in turn may drive demand in the economy. Combined with indications of a normal monsoon, the litmus test for the economy seems positive. Besides the anticipated increases in spending, the higher pay and pensions may also bolster savings, which could help the banking and financial system channel funds to meet investment demand.

Model GST Law – Insights of the new taxation regime

The release of the model GST law by the Ministry Of Finance is seen as a breakthrough on the deadlock over GST among the Centre and States. The government has unveiled the draft law ahead of the Monson Session (18 July to 12 August) where it hopes to witness the passage of the Bill. The law has already been passed in lower house of parliament, but needs to be cleared by the upper house where the ruling party BJP had so far lacked majority. Further, the release of GST Law provides a framework for businesses and tax departments to start gearing up for the upcoming regime.

Types of GST

The Model GST Law provides details of the architecture of the new regime on the basis of its prime objective to remove cascading of taxes. The law outlines the levy and collection of C(central)-GST and S(state)-GST. The proposed framework will subsume excise duty, customs duty and service tax into the CGST. Similarly, VAT and other local taxes are proposed to be subsumed into SGST and inter-state transactions shall be covered under IGST (Integrated GST). The CGST will be framed upon the model GST law. In addition, the states will draft their own SGST based upon the draft law with minor variations and incorporating state based exemptions.

At the outset, GST will see a transition from the maximum retail price (MRP) regime (prevalent under the existing law) to a transaction value concept with some valuation rules. Transaction value can be determined on basis of valuation rules such as transaction value of like kinds of goods or quality etc. and include all expenses in relation to sale, such as packaging and commission. This may have an impact across sectors such as retail, consumer electronics, FMCG, pharma, etc. where currently the MRP regime exists. The services sector, which currently deals with central service tax only, may now have to contend with multiple states having to obtain registration in the States from where they make a supply. This may impact key sectors such as financial services, telecom etc. from a compliance perspective.

Combined with indications of a normal monsoon, these implications are expected to have a positive impact on the economy. Besides the anticipated increases in spending, the higher pay and pensions are also expected to bolster savings, which could help the banking and financial system channel funds to meet investment demand.

June Manufacturing PMI at three-month high

The Nikkei Manufacturing Purchasing Managers' Index (PMI) rose to 51.7 in June from May's 50.7, its sixth month above the 50 mark that separates growth from contraction after it fell below 50 - level in December for the first time in more than two years. The main contributing factors to the upward movement in the PMI were stronger performance in indices of new orders and output, both of which reached three-month highs. The best-performing category was consumer goods. Meanwhile, June saw input costs increasing (at a weaker rate) for the ninth month now, with survey participants reporting higher prices paid for raw materials like metals, chemicals, plastics, textiles, petrol, food and paper.

Retail Inflation remains flat at 22-month high

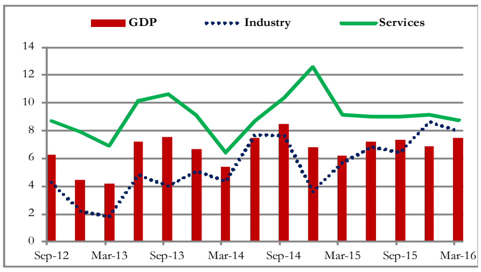
India's retail inflation marginally increased to 5.77% (y/y) in June, same as previous month with food inflation at 7.8% - a 22-month-high. This was led by a 27% surge in the cost of pulses, while sugar and confectionery rose 17% and vegetables at 15%. In comparison, the previous trends were an average of 2.7% during July-September (when monsoon had failed), 5.2% in March (during peak drought) and 7.5%-plus now (under the predicted normal monsoon this time). However, possible explanation for the current spike in food inflation is that the effects of drought are felt most during the summer months. This is the period when the Rabi crop has already been marketed and we are still some time away from the next crop's arrival from October. However, India's core inflation slowed to 4.5% in June from 4.7% in May, marking a second consecutive month of cooling retail prices outside of energy and food. The RBI's next policy review and incidentally Raghuram Rajan's last is on August 9 and in the previous review, the RBI Governor had cited inflationary pressures for maintaining the status quo on rates.

Monthly Economic Report June 2016

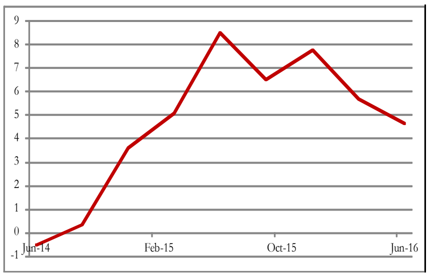
British High Commission New Delhi

GROWTH: *Core Sector growth slips to 5-month low at 2.8%*

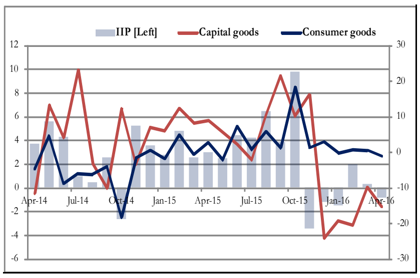
GDP



Projects Under Implementation

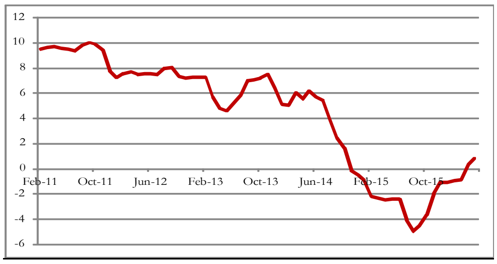


IIP/Capital/Consumer Goods

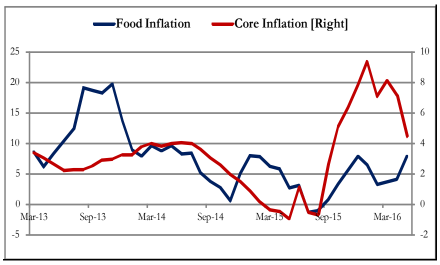


INFLATION: *Food Inflation at 22-month high 7.8%, Consumer Price Inflation at 5.77%*

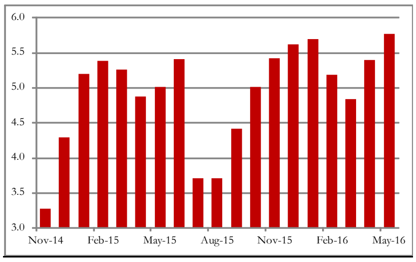
Wholesale Price Index (% y/y)



Food vs. Core Inflation (% y/y)

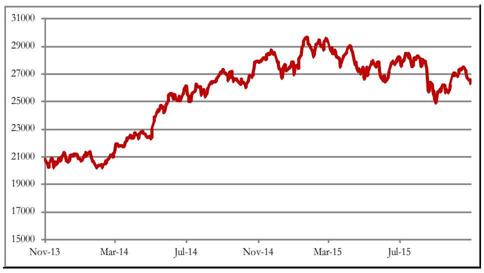


Consumer Price Index (% y/y)

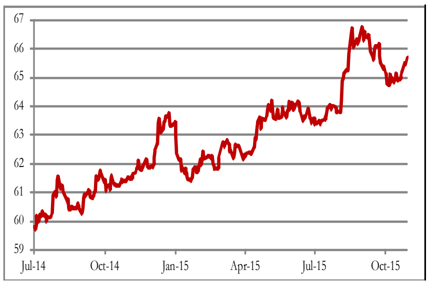


MARKETS: *Volatile capital and foreign exchange market due to global economic implications*

SENSEX



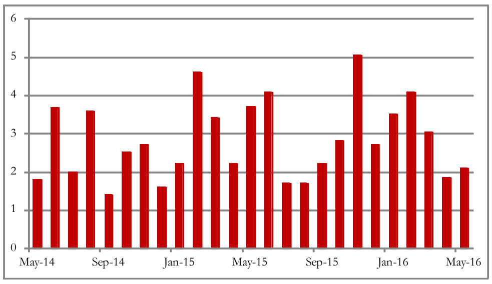
USD/INR



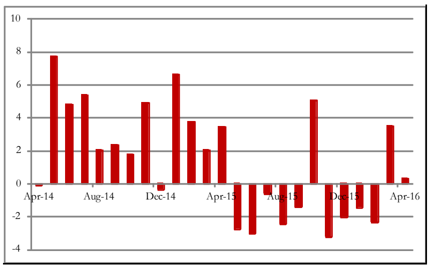
10yr Govt. Securities yield (%)

EXTERNAL: *FIIs trim exposure*

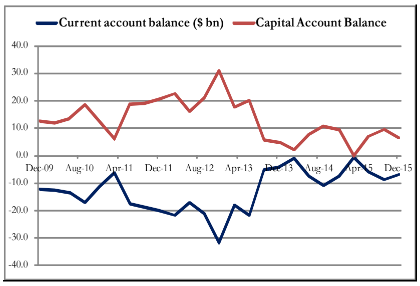
FDI ($ Bn)



FII ($ Bn)

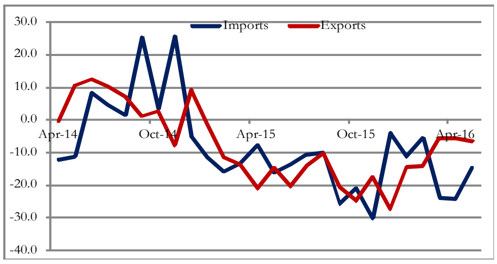


Current vs. Capital A/c ($ Bn)

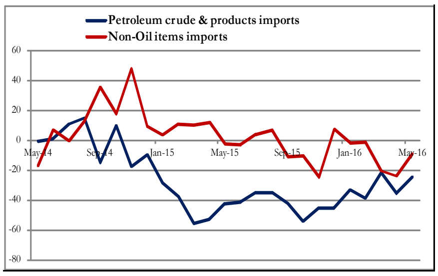


TRADE: *Imports improved y/y while Exports maintain upward trend*

Export/Import Growth (% y/y)



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



Trade Balance ($ Bn)