Monthly Economic Report July 2015

British High Commission New Delhi

SUMMARY

- GDP reaches $2tn, fiscal deficit improves and investment surges but factory output remains subdued and consumer inflation rises.
- Global agencies remain largely positive despite risks.
- Land Acquisition: 100 years and counting

A $2-TRILLION ECONOMY

India's nominal GDP crossed $2tn in 2014, according to the World Bank. After taking 60 years to reach $1tn, it added the next trillion in just seven years. However, despite increased per capita gross national income, India remains a 'lower middle income' country.

FISCAL SITUATION IMPROVES

The fiscal deficit in Q1 stood at 51.6% of Budget estimates for 2015-16, better than 56.1% in the corresponding period last year. Capital spending rose sharply with the government looking to turn around the investment cycle through higher public spending, given that private sector remains reluctant given high interest rates and lagging business confidence. The fiscal deficit target is 3.9% for 2015-16, a tad lower than 4% in 2014-15. The government has also extended the fiscal consolidation road map to bring down the fiscal deficit to 3% of GDP by one year to FY18.

SURGE IN FOREIGN INVESTMENT

Growth in FDI has been significant after the launch of Make in India initiatives in September 2014. Equity inflows increased 48% between October to April over the corresponding period last year. FII inflows also surged a record 717% to $40.9bn in 2014-15. Modi's government has amended FDI policy to remove many procedures and foster the investment climate.

INDUSTRIAL GROWTH SLOWS

Factory output growth slowed to 2.7% y/y in May as production of consumer goods contracted after a brief pickup in April, signalling that rural demand remains fragile amid a weak monsoon. IIP, which is

LAND ACQUISITION: 100 YEARS AND COUNTING

Land acquisition in India was governed by The Land Acquisition Act 1894. In 2013, the Congress government passed new legislation to ensure that the land is acquired strictly for public welfare projects and land owners are adequately compensated and rehabilitated. Business declared that viable land acquisition was simply impossible under the new terms. Modi agreed to look at the act again. The Bill is currently stuck in Parliament following widespread political protests. Controversial areas include:

The Congress Act requires consent of land owners for acquiring land. BJP proposes exempting 5 categories of projects (i) defence, (ii) rural infrastructure, (iii) affordable housing, (iv) industrial corridors and (v) infrastructure projects. These are also exempted from Social Impact Assessment and limits on acquisition of irrigated multi-cropped land. The government claims these exemptions are to expedite the process of land acquisition. Opponents have pointed out that these could cover most projects.

The Bill also changed the time period after which unutilised land must be returned from 5 years to 5 years or any period specified at the time of setting up the project. Thus, an entity with unutilised acquired land can keep it for the period it specifies for setting up the project, even if this is much more than 5 years.

Under the current Act, land can be acquired for the government, a PPP, or a private company, if the acquisition serves a public purpose. The Bill changes the term 'private company' to 'private entity', defined as an entity other than a government entity, including proprietorships, partnerships, companies, corporations, non-profit organisations, or other entities. This will enable, for instance, acquisition by private educational trusts.

Modi has made this legislation a centrepiece of his reform agenda. However, even BJP members, allies and organisations affiliated with the BJP's ideological parent, the RSS, have expressed reservations. The government has withdrawn these amendments and now aims to pass a diluted bill before parliament rises on 13 August. However, individual states can modify the law if they wish.

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normally volatile, was revised down to 3.4% from the provisional figure of 4.1% for April.

Core sector expanded at a slower pace of 3% in June against the six-month high 4.4% growth recorded the previous month and 7.3% growth recorded in June last year. This was mainly due to the base effect and contraction in crude oil and natural gas production.

RETAIL INFLATION ACCELERATES

Consumer inflation climbed to an 8 month high of 5.4% in June from 5% in May, on account of a sharp rise in the prices of vegetables and pulses. The RBI held its policy rate at 7.25% as expected, but raised hopes of a cut before the end of the year if the monsoon is normal and a global supply glut prevents oil prices from climbing. Since January, RBI has cut its policy rate by 75 basis points from 8% to 7.25% in three stages, but banks have cut their loan rates by only around 30 basis points.

MIXED OUTLOOK

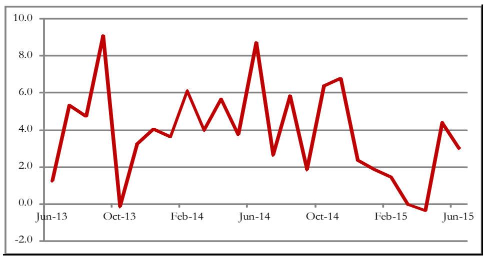
The IMF World Economic Outlook Update retained India's growth projection at 7.5% this year, higher than China's 6.8%. It forecasts India as the world's fastest growing economy, for the second consecutive year in 2016 at 7.5 %. However, its projection is lower than the Finance Ministry which expects the country to grow at 8-8.5% in 2015-16.

The ADB also reaffirmed its growth forecast, pegging GDP to grow at 7.8 % in FY16 and 8.2 % in FY17. While there continues to be some uncertainty on the monsoon , ADB notes that summer crop sowing has increased by 57.6% over last year. This is expected to boost agricultural growth. On the revival of the investment cycle, ADB holds the position that the rise in the number of new investment projects announced, which has continued to increase for the fourth consecutive quarter during the quarter ending in June, indicates brighter investment sentiment. It adds that indirect tax collections in the first quarter of FY2015 indicate a recovery in manufacturing. But risks to growth prospects stem from delays in passing crucial legislation such as the GST and the land acquisition.

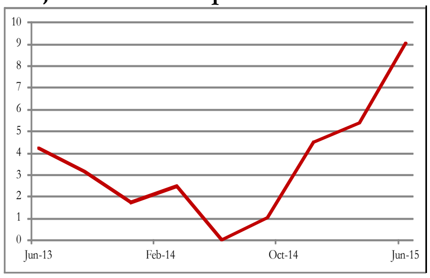
Fitch has lowered India's growth projections to 7.8% for the current fiscal from 8% on lower than expected pickup in demand. It, however, expects India's GDP to surpass China's for the first time since 1999, forecasting acceleration to 8.1% in 2016-17 before settling back to 8.0% in 2017-18. The global rating agency said the business environment remains relatively weak compared with peers and will take time to turn around. Fitch's view follows another global giant, Moody's, warning of growing concerns about policy stagnation.

GROWTH: *Industrial production growth slows to 2.7% in May*

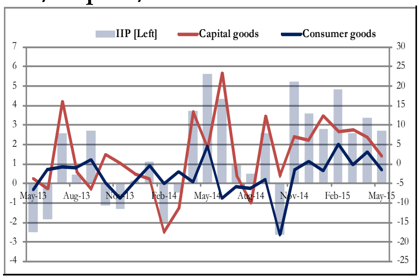
Core Infrastructure Industries



Projects Under Implementation

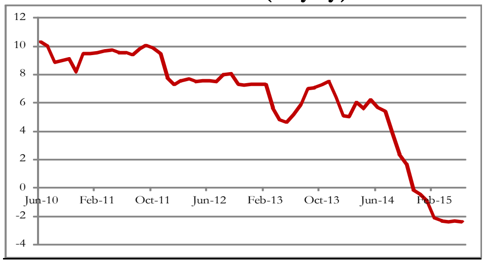


IIP/Capital/Consumer Goods

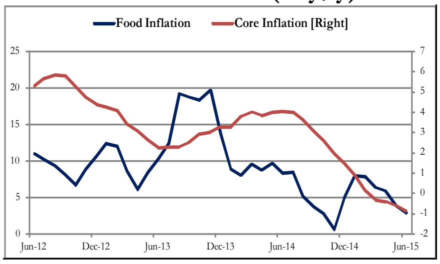


INFLATION: *Retail inflation moves up in June to 8-month high of 5.4%*

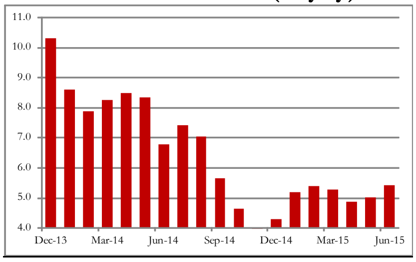
Wholesale Price Index (% y/y)



Food vs. Core Inflation (% y/y)

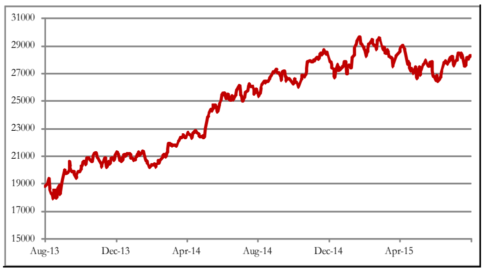


Consumer Price Index (% y/y)

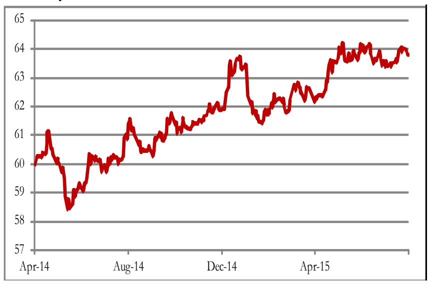


MARKETS: *Rupee remains range-bound*

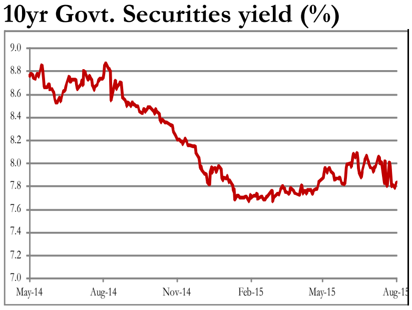
SENSEX



USD/INR

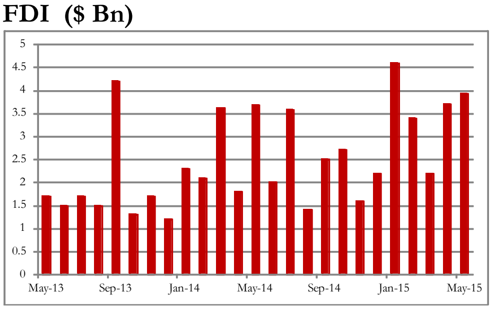


10yr Govt. Securities yield (%)

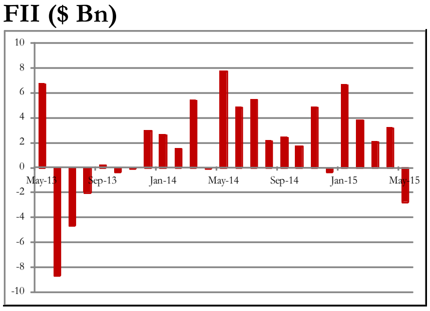


EXTERNAL: *FDI surges*

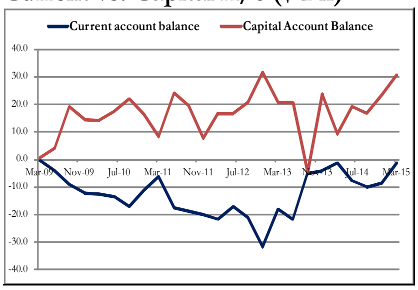
FDI ($ Bn)



FII ($ Bn)

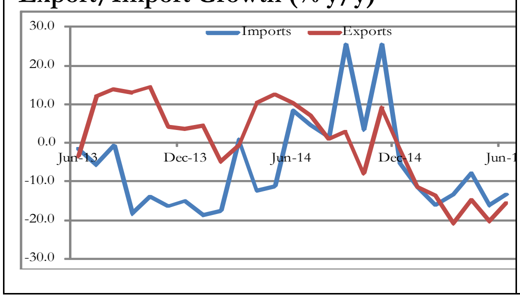


Current vs. Capital A/c ($ Bn)

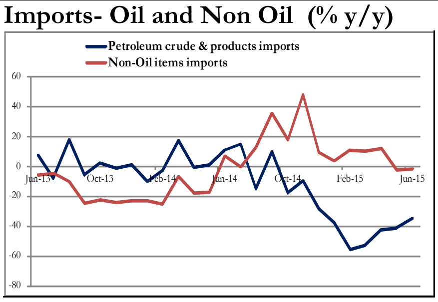


TRADE: *Exports continue slide for 7th month; down 15.8% in June*

Export/Import Growth (% y/y)



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



Trade Balance ($ Bn)