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Monthly Economic Report July 2014

British High Commission New Delhi

Summary

- Monsoon update – Improvement in July but drought risk remains.
- Food inflation spikes; government responds
- Positive news on some growth indicators.

Monsoon Update

While the monsoons this year have been disappointing, the situation has improved slightly. We are now halfway through the monsoon season and cumulative rainfall deficiency has narrowed to 24% below normal, compared to 43% at the end of June. (NOTE: rain deficiency exceeding 25% below normal over at least one-fifth of the country is defined as drought).

Similar trends reflect in the data on sowing coverage and reservoir levels. Sowing coverage for *Kharif* crops (June-Oct season, crops like rice, maize, millets, etc.) is 23% below normal, compared to 40% last week. Reservoir levels are holding steady, currently at 4% higher than the long term average.

A stronger monsoon in July has dramatically improved prospects for this year's harvest; rains during August and September will determine if it's an official drought.

Food inflation spikes: vegetables drive price rises

While the overall indices of inflation remain stable (consumer price growth recorded at around 7% in June from 10% last year), there have been some sharp spikes in food prices over the past weeks. Tomato prices have spiked by over 200% recently (300% rise last month in Delhi).

The government has stepped in. It has taken a number of proactive steps to contain inflation. The government sets purchase prices for many key commodities; it has raised these only slightly. It has also brought food stocks onto the market to increase supply, while exports, hoarding and futures trading have been disincentivised. A line of credit has been extended to states importing edible oils and pulses. Significantly, the government is also looking at the politically difficult step of dismantling the Agriculture Produce Market Committee Act (APMC), which restricts farmers to sell only to licensed middlemen, creating a state-sponsored anti-competitive environment that penalises both the consumer and farmers.

Growth starting to look up

Another brick in the BRICS Bank

Leaders of the BRICS nations gathered in the Brazilian city of Fortaleza for their sixth annual summit on July 15th. As part of the summit they announced the creation of two financial arrangements: the New Development Bank (NDB) to finance infrastructure and sustainable development projects and the \$100bn Contingent Reserve Arrangement (CRA), to tide over members in financial difficulties.

The bank will have initial subscribed capital of \$50bn and maximum allowable capital of \$100bn. Each country will pay in \$10bn, giving them a theoretically equal say. It will be based in Shanghai. Yet the presidency will be rotated, starting with India. China will not have a turn until 2021.

India is estimated to need \$500bn in infrastructure spending, and the new infrastructure bank will be one more option the government can use to achieve this.

It remains to be seen how this institution will fit with other similar formations (Prime Minister Modi has proposed a SAARC development bank; China heading an initiative to set up an Asian infrastructure bank) and the challenge it will pose to existing institutions like the World Bank and the IMF.

Previously battered growth indicators, seem to be now recovering. India's manufacturing Purchasing Managers' Index rose to a seventeen-month high of 53 in July from 51.5 in June (a reading above 50 indicates likelihood of

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expansion). The new orders index rose sharply to 55.9 in July from 53.0 in June, which is indicative of a very strong pick-up in domestic demand.

Similarly, infrastructure sectors posted a strong growth of 7.2% (y/y) in June – also a seventeen-month high. Interestingly, the poor monsoon has helped some sectors which would normally be negatively effected by heavy rain; cement production rose to a twenty one-month high of 13.5% while coal output grew by over 8.1%.

Commissioning of projects in the manufacturing sector for the quarter ending June 2014 grew significantly by 80% (y/y). Over 70 projects with investments worth £2.8 bn were commissioned during the quarter, although the bulk of this came from the top 10 projects. These include some of the large projects which were scheduled for completion in fiscal 2013-14, but had overshot deadlines.

Government's latest policies

Significant policies recently enacted include an increase in the FDI cap to 49% in defence and railway projects, though a similar change to the insurance sector has been held up by the opposition. Through a quick series of notifications, the environment ministry has diluted rules for environment and tribal rights' regulations pertaining to mining, road, power and irrigation projects. To expedite consensus on the Goods and Services Tax (GST), the central government has ordered the release of £2.5bn to states as a 'good will' gesture to fulfil their long standing demand of compensation for their losses on the previously passed central sales tax. This amounts to almost 75% of the states' claims. Among initiatives to improve the business environment, the labour ministry has liberalised the strict 'inspection raj' regime for labour laws. The government has also cleared long-pending amendments to three critical laws in the sector that would enable a doubling of the overtime limit for workers, exemption for firms employing up to 40 workers from compliance of labour regulations and amending laws on apprenticeship. These come on the back of a slew of labour reforms that the BJP government in Rajasthan has suggested recently.

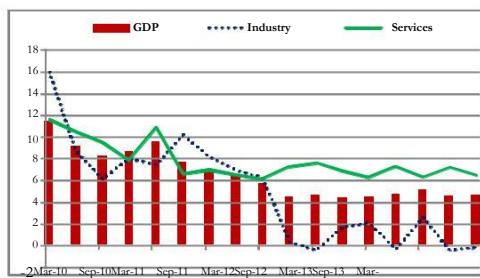
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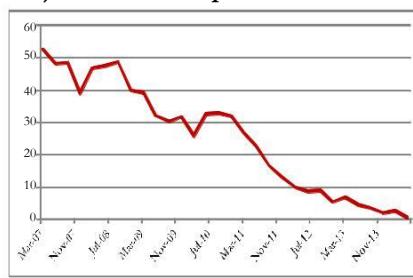
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GROWTH: Industrial output soars to 19-month high of 4.7% (y/y) in May 2014

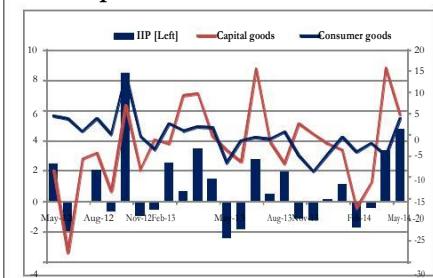
GDP



Projects Under Implementation

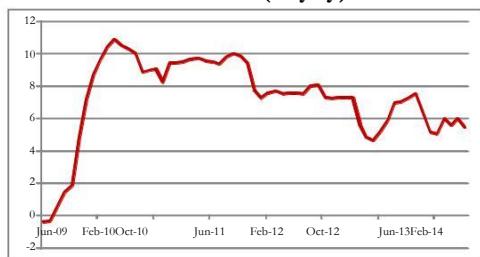


IIP/Capital/Consumer Goods

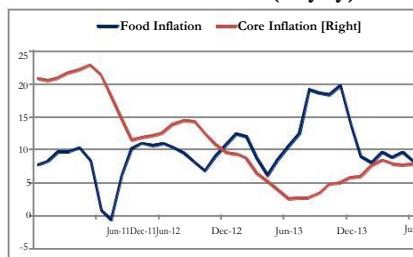


INFLATION: Consumer price inflation fell to 30-month low of 7.3% (y/y) in June 2014

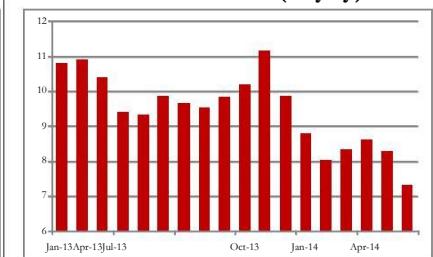
Wholesale Price Index (% y/y)



Food vs. Core Inflation (% y/y)

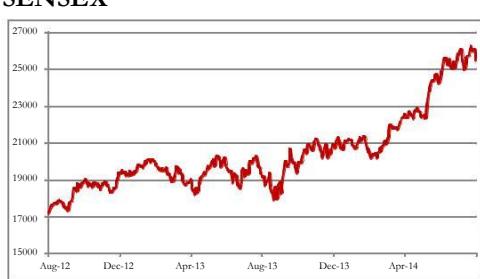


Consumer Price Index (% y/y)

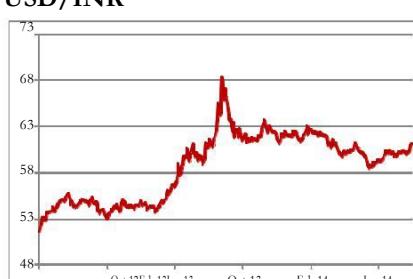


MARKETS: Rupee fails to maintain upward trend; ends at over 4-month low of 61.18 against US dollar

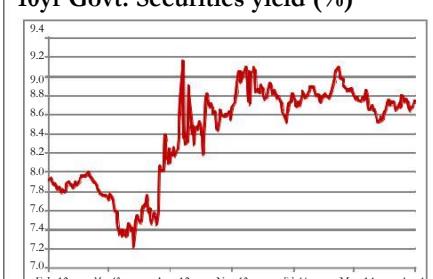
SENSEX



USD/INR

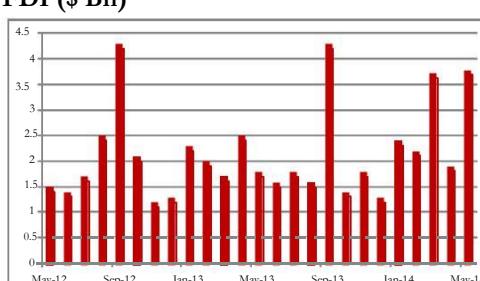


10yr Govt. Securities yield (%)



EXTERNAL: FII rises to \$7.7bn in May 2014

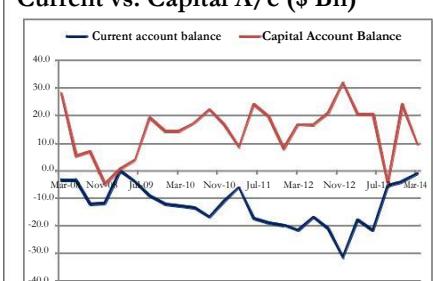
FDI (\$ Bn)



FII (\$ Bn)

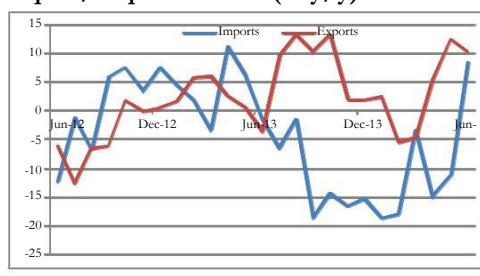


Current vs. Capital A/c (\$ Bn)

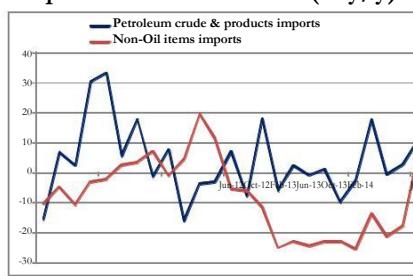


TRADE: June trade deficit rises to 11-month high on gold imports

Export/Import Growth (% y/y)



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



Trade Balance (\$ Bn)

