Monthly Economic Report December 2015

British High Commission New Delhi

SUMMARY

- Food inflation increases
- Industrial growth: a mixed picture

Food inflation rises

There has been a sharp spike in both the consumer price index inflation (CPI) and Wholesale Price Index inflation (WPI), driven by a surge in food inflation, mainly in pulses.

WPI has been negative since November last year. It contracted by 2% (y/y) compared to a contraction of 3.8% last month, and 0.2% last year. However bucking this trend, food inflation rose to 5.2% from 2.4. Vegetables jumped by 14%, and pulses and onions rose by over 50%. Inflation fell in the fuel and power segment by 11%, while for manufactured products it fell 1.4% in November.

Part of the reason for the negative WPI trends is plunging crude prices as well as the slowdown in global markets. On the other hand, high food inflation is partly owing to a fall in India's production by 4.6% (to 253m tonnes) owing to erratic rainfall. The fall was steeper (10%) in pulses, resulting in retail prices skyrocketing.

Retail Inflation (CPI), the key price indicator of the Reserve Bank of India (RBI) for policy purposes, rose to a 14 month high at 5.4% (y/y) in November, from 5% in the preceding month – owing to the high weightage of food in its index. It was 3.3% this time last year.

GST- step further to a decade old promise

A panel headed by the Chief Economic Adviser Arvind Subramanian has submitted a report which suggests a revenue neutral rate (RNR) - allowing the government to maintain fiscal balance despite changes in tax laws. Its recommendations peg the GST rate at 15-15.5% (if petroleum, electricity, alcohol and real estate are excluded). The committee also argues that a more implementable version could be a three tier rate structure: a standard 17-18% rate for all services and most goods, 12% for a few essential items and 40% for luxury cars, tobacco and aerated beverages. The report is not in favour of the distortive 1% inter-state tax that was earlier discussed and is against hard wiring tax rates in the bill as it would defeat the spirit of a GST.

The RBI's Policy

The RBI maintained its key repo rate as retail inflation has been on a rising trend for the past few months. The RBI has a retail inflation target of 5.8% for this month and a medium term target of 5%. It had reduced the repo rate (at which it lends money to banks) by 125 basis points (1.25%) since January 2015 - including a 50 basis point cut in September – in response to slow growth and easing inflation. It paused this easing process in December citing inflation concerns. Despite the RBI's lead, the banking sector has not yet passed the whole benefit of the interest rate reduction to borrowers. The cost of loans has come down by only 60-70 basis points.

Industrial Growth

The October industrial production grew 9.8%, on the back of robust growth in consumer products and capital goods during the autumn festive season. This is the highest growth in last five years. A part of this spurt is due to a favourable base effect since production contracted 2.7% last October. The growth in the consumer durables segment was 42.2% over the same month last year, capital goods grew 16% and basic goods 4%.

In contrast, the Manufacturing Purchasing Managers' Index (PMI) dropped to a more than two year low in December at 49.1 (a reading below 50 implies the likelihood of contraction). The index fell for the sixth consecutive month. However, the PMI reading is better than other countries in emerging Asian economies like South Korea, China, Taiwan, and Malaysia.

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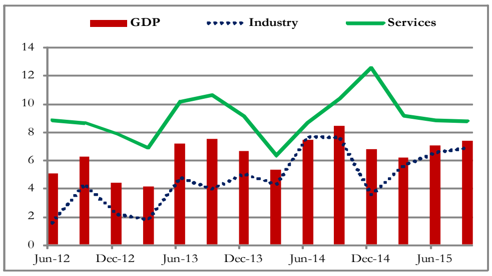
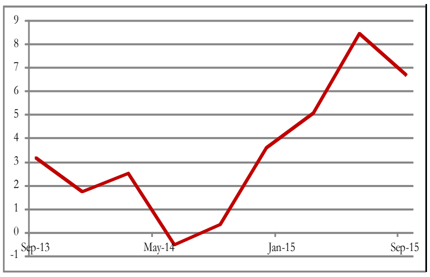
GROWTH: *October IIP positive*

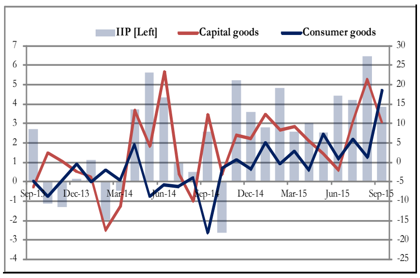
GDP



Projects Under Implementation

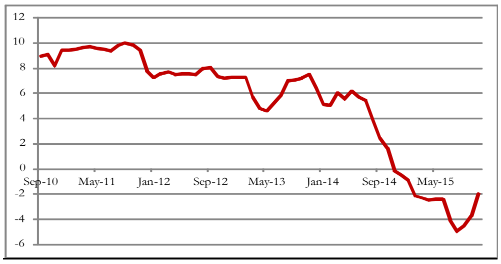


IIP/Capital/Consumer Goods

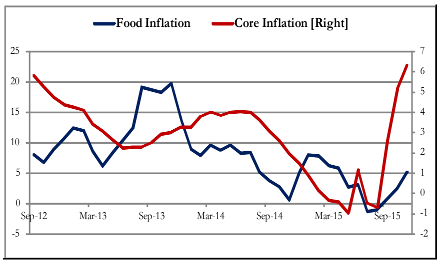


INFLATION: *Inflation accelerates due to surge in food prices.*

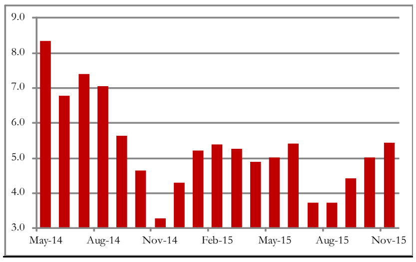
Wholesale Price Index (% y/y)



Food vs. Core Inflation (% y/y)

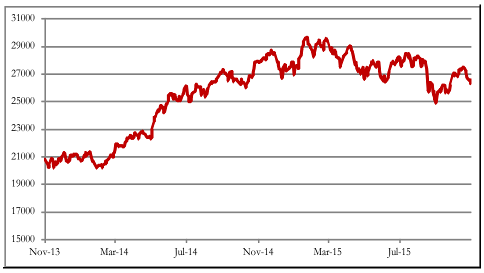


Consumer Price Index (% y/y)

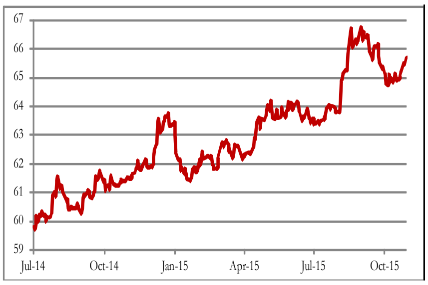


MARKETS: *USD-INR exchange rate at 66.14*

SENSEX



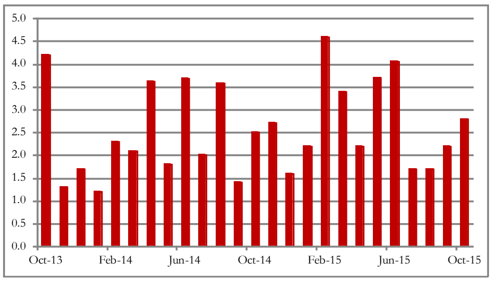
USD/INR



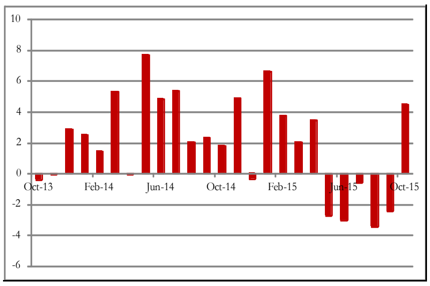
10yr Govt. Securities yield (%)

EXTERNAL: *FIIs were accounted at $4.5bn and FDIs at $5bn.*

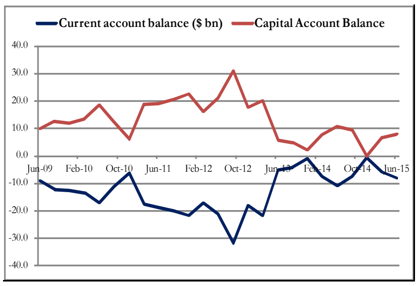
FDI ($ Bn)



FII ($ Bn)

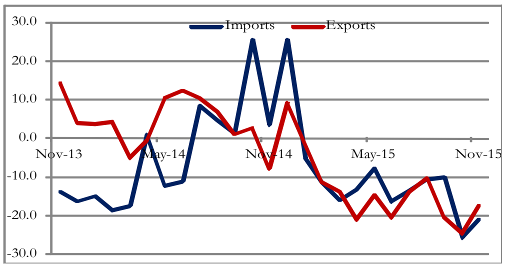


Current vs. Capital A/c ($ Bn)

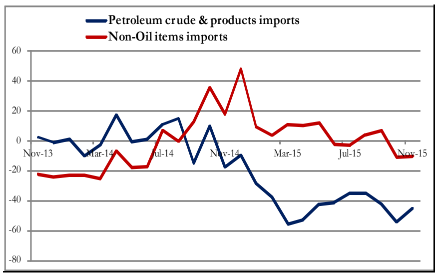


TRADE: *Export and Imports reviving after long haul of downward trend*

Export/Import Growth (% y/y)



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



Trade Balance ($ Bn)