January 2015

INDIAN ECONOMY

CRISIL Insights

Through the monthly CRISIL Insights Indian Economy series, we offer incisive analysis of macroeconomic parameters of the country. In the January issue, we provide an outlook for growth in the next fiscal.

India to cross 6% growth hurdle in 2015-16

The outlook for fiscal 2016 and beyond will be shaped by a mix of global developments and domestic factors, especially how quickly and effectively bottlenecks are resolved, pending reforms are pushed through, and the investment cycle gets kick-started. Numerous steps taken by the government this fiscal have improved business and consumer sentiment. These steps have provided a mild boost to the economy during 2014-15, and will also support growth in the next fiscal.

An improvement in private consumption demand led by an increase in discretionary spending is expected, now that food and fuel inflation will be lower, interest rates are brought down and farm incomes improve in a year of normal monsoon. This will lead to some improvement in capacity utilisation rates, especially in sectors such as auto and consumer durables. A pick-up in mining activity, too, is envisaged, given the government's focus on completing the auctioning process before March 2015. These will ensure that the economy enters the 6% orbit in fiscal 2016.

The convergence of proactive steps by the government (release of excess food stocks and slower rise in minimum support prices) and falling oil prices have brought down inflation significantly. That the inflationary expectations are firmly anchored was reflected in the RBI's out-of-policy rate cut on January 15. We expect inflation to average lower at 5.8% in FY16 compared to an estimated 6.7% in Fy15. This creates room for further rate cuts next fiscal.

The key challenge before the government is to revive manufacturing activity and turn the private investment cycle around. Despite attempts at improving the business climate, high leverage, under-utilised capacities, low profits and stress in the banking sector will hinder the revival of private corporate investment. In this scenario, the government will need to find ways of pushing up public investment to support growth without jeopardising the fiscal balance. For one, it needs to re-orient its spending away from subsidies towards investments. Additionally, it needs to explore avenues for generating fresh resources for these investments via stake sales, spectrum revenues, etc. The forthcoming Union Budget may well be a pointer to how this could be achieved.

Monetary Policy	Industrial Production	Inflation
RBI surprises with out-of-policy repo cut	IIP growth speeds up as manufacturing shows improvement	Inflation remains low even as base effect wanes

MONETARY POLICY

- After one full year of staying on hold, the RBI, in a surprise move, announced a 25-basis point cut in repo rates on January 15, before its upcoming monetary policy review on February 03. This is a welcome move. It suggests the reversal of RBI's monetary policy and is a harbinger for a lower interest rate regime going ahead.
- Disinflationary developments along with the government's resolve to adhere to its fiscal deficit target provided the RBI headroom to start cutting rates. Lower interest rates would help in making domestic demand and investment conditions more conducive.

INDUSTRIAL PRODUCTION

- In November, IIP grew by 3.8% y-o-y after falling by 4.2% in the previous month. The recovery was led by a mild uptick in manufacturing, a steady momentum in mining output that is benefiting from a weak base and continued strong growth in electricity production
- The manufacturing, mining and electricity sectors grew by 3.0%, 3.4% and 10.0% y-o-y respectively in November as compared to -7.4%, 4.9% and 13.3% in October. In aggregated terms, there is only a modest uptick in industrial activity; IIP growth in Q3 (October and November) has been 2.2% compared to 1.4% in Q2.

INFLATION

- Lower than most expectations, CPI inflation rose to 5% y-o-y in December from 4.4% last month. As the strong base effect wore off, food inflation rose to 4.8% in December from 3.1% in November. However, excluding vegetables, food inflation stepped down in most other food items such as cereals, pulses, egg, fish and meat, etc.
- CPI core inflation came down to 5.5% y-o-y in December compared to 5.8% in November. This is the lowest core inflation recorded since the beginning of the new CPI series. Inflation fell in recreation & amusement, personal care and transport and communication categories.
- WPI inflation increased mildly to 0.1% y-o-y in December from 0% in November as food price inflation rose 5.2% as against 0.63% growth in previous month. Inflation in manufactured items declined to 1.6% from 2.0% and fuel inflation contracted by 7.8% after contracting 4.9% last month.

CRISIL GLOBAL RESEARCH & ANALYTICS

Interest Rate	Rupee	Trade
Bond yields continue to decline	Rupee falls to a 9-month low in November	Trade deficit narrows to 10 month low

INTEREST RATE

- The 10-year benchmark 8.40% 2024 bond edged down on a month-end basis to 7.85% in December from 8.09% in November. On a monthly average basis, too, yields were lower at 7.92% in December compared to 8.17% in November.
- Yield on the 1 year G-sec bond also moderated on a month-end basis to 8.21% in December from 8.29% in November. On a monthly average basis, too, yields were lower at 8.20% in December compared to 8.31% in November.
- Slowdown in inflation and falling crude oil prices along with expectations of a rate cut by the central bank have been continuously bringing down bond yields. Though inflation edged up slightly in December, owing to the waning of the base effect, it largely remains on a downward trend. Oil prices fell further to $57.2/barrel in December from $70.5/barrel in November.

RUPEE

- The rupee ended 2014 at 63.3 per dollar, depreciating by 2.2% compared to November-end. On a monthly average basis, the rupee stood at 62.8/$ in December as compared to 61.7/$ in November. On account of year-end profit booking, December saw the lowest monthly net FII inflow (debt and equity combined) at $2 billion since May 2014
- Other factors that impacted the rupee in December were a rise in dollar demand from oil importers, disappointing macroeconomic data released during the month and the strengthening of the dollar itself amidst a strong US economic recovery.

TRADE

- Exports in December stood at $25.39 billion, falling by 3.8% y-o-y, as compared to a 7.3% rise in November. Imports too fell by 4.8% to $34.83 billion in December after rising by 26.8% in November.
- Despite negative export growth, the trade deficit in December fell to $9.94 billion - the lowest since February 2014 - as imports fell by a greater magnitude mostly on account of a sharp reduction in oil and gold imports. While oil imports declined by 15.1% over the previous month to $9.9 billion, gold imports dropped by 76% to $1.34 billion.

Source: CRISIL Research

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