India Macro Newsletter

June, 2013

I. Macro Economic Review

- ***GDP Growth –*** *GDP grew at 4.8 per cent (year-on-year) in Q4 (January to March) of 2012-13. The estimates for the GDP growth for the FY 2012-13 stood at 5 per cent. The industrial output contracted by 1.6 per cent in May, 2013. Contraction in output was witnessed in basic, capital and consumer goods. On investments, the recent decisions of the Cabinet Committee on Investments (CCI) are a big positive, however, it will take some time before these reflect in the real activity data. The Purchasing Manager's Index (PMI) stood at 50.3 up marginally from 50.1 in May, 2013. In the agriculture sector, the third advance estimates of crop production released by the Ministry of Agriculture showed a slight upward revision as compared to their second advance estimates. The onset of the South-West monsoon has been strong and on time.*

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- ***Inflation –****The WPI Inflation remained below the RBI's threshold of 5 per cent in the month of June at 4.86 per cent, but increased marginally compared to 4.70 per cent last month. The WPI inflation stood at 7.58 per cent in the corresponding period last year. The CPI (new series-base =2010) for the month of June,2013 increased to 9.87 per cent as compared to 9.31 per cent in May ,2013. An increase was also witnessed in the Purchasing Manager's Index (PMI) input and output prices.*

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- ***Fiscal Performance*** *–Fitch revised India's outlook to stable (from negative). According to the accompanying statement, the key drivers of the outlook change include the government's success in meeting last year's budget deficit, measures put in place to kick start the investment cycle, contain inflation and expectations of a gradual recovery. The Central Government's fiscal deficit was reported at 4.9 per cent, lower than the estimated 5.2 per cent of GDP and that of 5.7 per cent a year earlier. The Government has pegged its fiscal deficit estimate at 4.8 per cent of GDP for 2013-14, in line with the fiscal consolidation roadmap it had outlined last year.*

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- ***External Sector and Trade –****The Current Account Deficit (CAD) narrowed to 3.6 per cent of GDP in the January-March quarter from 6.7 per cent in the previous quarter and was financed with strong capital flows. The overall trade deficit for April-June, 2013-14 was estimated at USD 50.18 billion which is higher than the deficit of USD 42.21 billion during the same period in the previous fiscal. The trade deficit shot up on account of relatively lower exports as compared to imports. The recent volatility and the depreciation of the Indian Rupee has certainly put pressure on the CAD but the Rupee is expected to strengthen from the current levels on account of the domestic policy reforms which are likely to boost domestic and foreign investor sentiment.*

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- ***Capital Markets-*** *An important element supporting India's growth dynamics has been the significant growth in the foreign capital inflows over the last few years. Several measures have also been taken by the Government recently to encourage the availability of foreign funds for financing infrastructure. Measures have also been taken by Securities & Exchange Board of India (SEBI) and the RBI to remove regulatory hurdles and promote the growth of corporate bond markets.*

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This review has been prepared by Ms Archana Naresh, OSD to Secretary, Economic Affairs. I am grateful to Dr. Arvind Mayaram, Secretary, Economic Affairs for his valuable comments and suggestions. Thanks are also due to Mr Aman Mohunta , Economist, Office of the Chief Economic Adviser for providing critical inputs.

1. GDP Growth

According to the IMFs latest World Economic Outlook (WEO), global growth is projected to remain subdued at slightly above 3 per cent in 2013 , the same as in 2012. This is less than the forecast that was released in April,2013. The revised projections are driven to a large extent by appreciably weaker domestic demand and slower growth in several key emerging market economies as well as a more protracted recession in the euro area. India's growth forecast for 2013-14 has been lowered to 5.6 per cent as against 5.8 per cent projected in April,2013.

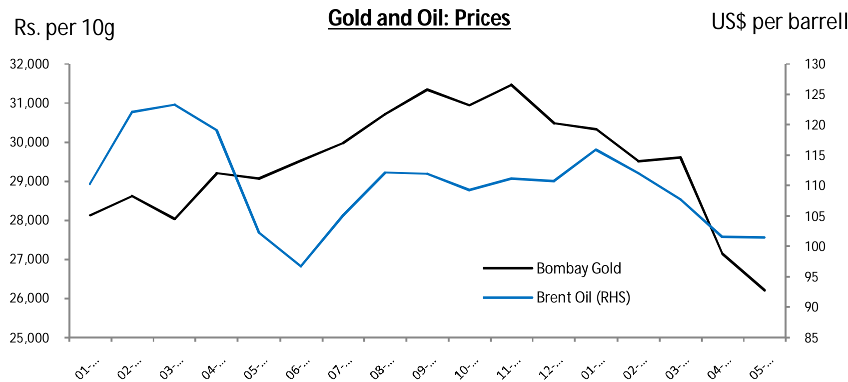
India's outlook was revised to stable by Fitch Ratings.

The Outlook was revised keeping into consideration the following factors:

- **Containing the fiscal deficit at 4.9 per cent of GDP in 2012-13.**
- **Efforts of the Government to kick start the investment cycle.**
- **Easing of inflationary pressures.**

GDP grew at 4.8 per cent (year-on-year) in Q4 (January to March) of 2012-13.The provisional estimates for the GDP growth for the FY 2012-13 stood at 5 per cent.

Since early April, oil and gold prices have moderated substantially, and if continued, bode well for lowering inflation, the current account deficit and the fiscal deficit.



Source:CEIC

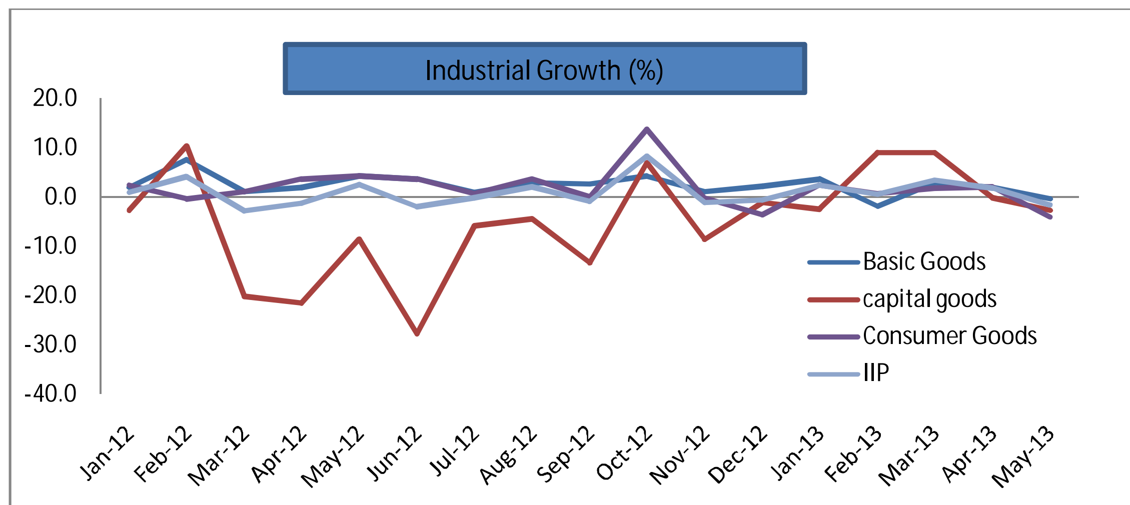
On the real economy, the current trends across sectors are discussed below –

i. **Agriculture – Last year's robust Rabi production and good start to the monsoon augurs well for agricultural growth prospects.**

- As per the third advance estimates of production of major crops released by the Ministry of Agriculture, India's total food grain production is likely

to be 255.36 million tonnes. The foodgrain production was earlier estimated at 250.14 million tonnes as per second advance estimates which were released in February, 2013. This is likely to help revive demand in rural areas which in due course of time also contribute to the stronger industrial performance on account of linkages.

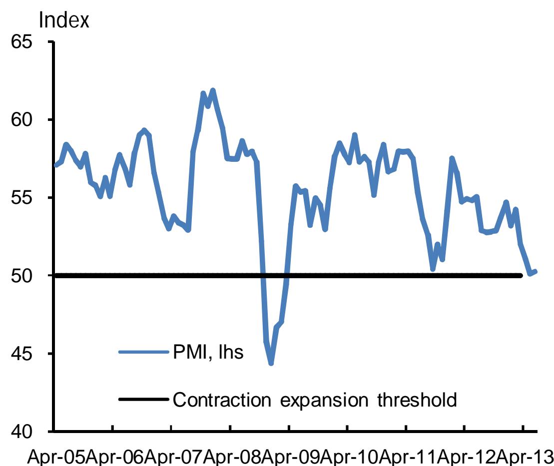
(ii) The Index of Industrial Production (IIP) contracted by 1.6 per cent in May, 2013. Contraction in output was witnessed in basic, capital and consumer goods.

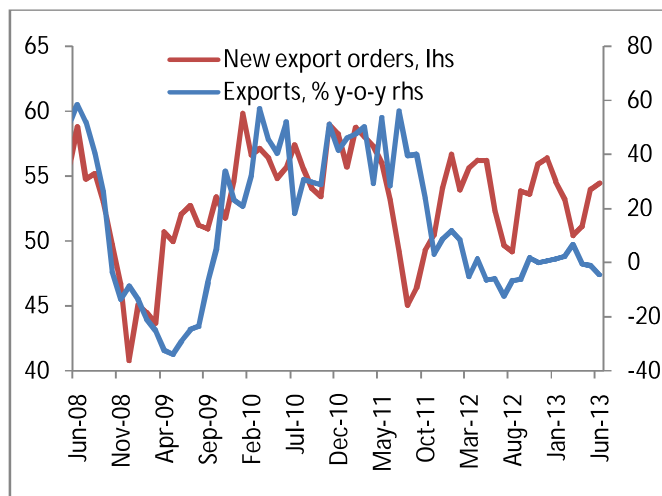


Source:CSO

ii. The HSBC Emerging Market Index (EMI) sank to 50.6 in June, indicating only a marginal increase in output across global emerging markets. Among the largest emerging market economies, output stagnated in China registering a marginal fall for the first time since August, 2012. This mainly reflected lower manufacturing production, as services activity registered another mild increase. Meanwhile, output stagnated in Russia, while India and Brazil both posted weak growth rates.

iii. The seasonally adjusted HSBC **Purchasing Managers Index (PMI)** which is a composite indicator of manufacturing inched up to 50.3 in June as compared to 50.1 in May.





Source: Markit Economics,DGCI&S

Several measures are being taken by the Government to boost investments and remove infrastructure bottlenecks. The Cabinet Committee on Investments (CCI) has been meeting at regular intervals and has already cleared stalled gas, power, roads and coal projects. In six meetings held so far, the CCI has taken decisions/cleared a total of 137 projects worth USD 48.47 billion. The sector wise break up and the number of projects cleared in respect of each are presented in the table below. In a recent meeting, chaired by the Prime Minister, the Government took a decision to put in place an institutional mechanism to track stalled projects – both in public and private sectors with an objective to remove the implementation bottlenecks.

Proposals having foreign investment inflow of more than USD 0.089 billion approved by the Foreign Investment Promotion Board (FIPB) since January 2013 till date.

Name of the Entity	FDI/NRI inflows (in USD billion)
M/s Multi Screen Media Pvt. Ltd.	0.09
M/s Ingka Holding Overseas B.V.	1.88
M/s Decathlon Sports India Pvt. Ltd.	0.12
M/s Claris Otsuka Limited, Ahmedabad	0.18
M/s Glynwed Pipe Systems India Private Limited, Mumbai	0.14
M/s Yes Bank Limited, Mumbai	0.47
M/s Vijay Television Pvt. Ltd.	0.17
M/s Telenor Mobile Communication AS, Norway	0.18

Number of Projects benefitted by the decisions taken by the CCI

Sector	Number of Projects cleared
Petroleum & Natural Gas	31
Power	13
Coal	12
Iron &Ore	01
Port	42
Roads	38
	Total=137

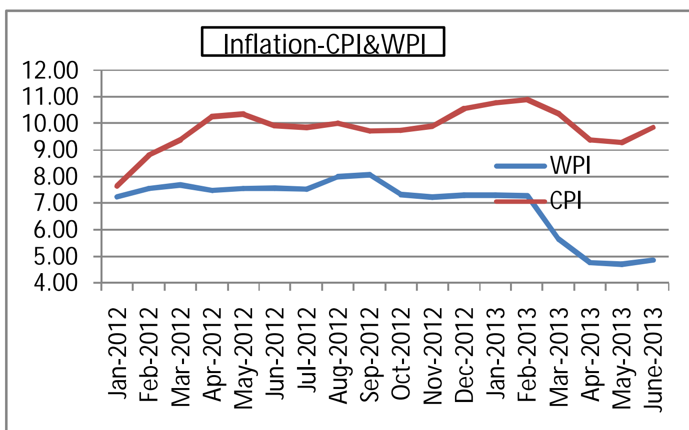
Liberalization of **Foreign Direct Investment (FDI) in retail, aviation, insurance and broadcasting, deferment of General Anti Avoidance Rules (GAAR), relaxation in the External Commercial Borrowings (ECBs) guidelines, launch of Infrastructure Debt Funds (IDFs)** in due course of time are expected to spur investments.

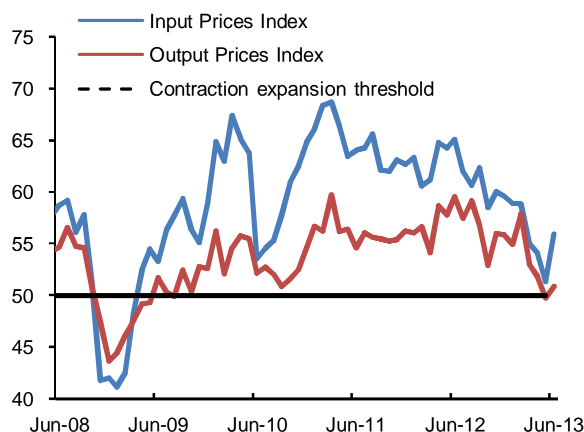
2. Inflation

The WPI Inflation remained below the RBI's threshold of 5 per cent in the month of June at 4.86 per cent, but increased marginally compared to 4.70 per cent last month. The WPI inflation stood at 7.58 per cent in the corresponding period last year. The CPI (new series-base =2010) for the month of June,2013 increased to 9.87 per cent as against 9.31 per cent in May,2013. An increase was also witnessed in the Purchasing Manager's Index input and output prices.

Global Commodity Prices, May 2013.

The global commodity prices for the month of May, 2013 were released by the World Bank recently. Inflation was negative for all broad groups except grains in May, 2013. Even the food inflation which had witnessed an upsurge in prices in Q2 and Q3, prices in recent months show a moderating trend thereby indicating that domestic inflation particularly the non-food inflation may not witness any undue pressure.





Source:RBI,Markit

Inflation Index Bonds (IIBs)

Pursuant to the Budget announcements, the Government in consultation with the RBI has decided to launch Inflation Index Bonds (IIBs), as instruments that will protect savings of poor and middle classes from inflation and incentivize household sector to save in financial instruments rather than investing in gold.

3. Fiscal Performance

The Central Government fiscal deficit stood at 4.9 per cent, lower than the estimated 5.2 per cent of GDP and 5.7 per cent of GDP a year earlier. The Government could better its own target due to the corrective actions it initiated on the expenditure side, for example; rationalization of diesel and fertilizer subsidies, capping of subsidized cylinders, delinking of petrol prices etc.

The Government has pegged its fiscal deficit estimate at 4.8 per cent of GDP for 2013-14, in line with the consolidation roadmap the Government has outlined. This is expected to come from **higher tax surcharges, a one-time voluntary compliance scheme to motivate registered firms to pay service tax dues, increase in indirect tax on select goods and revenues from disinvestments and spectrum sales.**

Government's commitment to reforms

The government is focused on several structural changes which will accrue benefits for years to come. The recently launched Direct Benefit Transfer (DBT) scheme with the Unique Identification (UID) system is expected to plug leakages in the present method of indirect subsidies. The Government is also making concerted efforts to introduce the **Goods and Services Tax (GST)** at the earliest.

On expenditure, **substantial saving is expected from cutting the subsidy bill, especially fuel subsidy**. In general, the split of expenditure has moved from non-plan towards the more growth enhancing plan expenditure.

Direct Benefit Transfer (DBT) scheme

In October 2012, the direct benefits transfer (DBT) system was put in place. It is expected to substantially eliminate leakages and would help in better targeting of subsidies in various programs such as in Public Distribution System, rural employment schemes, distribution of pensions and scholarships, financial inclusion schemes, provision of subsidized LPG cylinders etc.

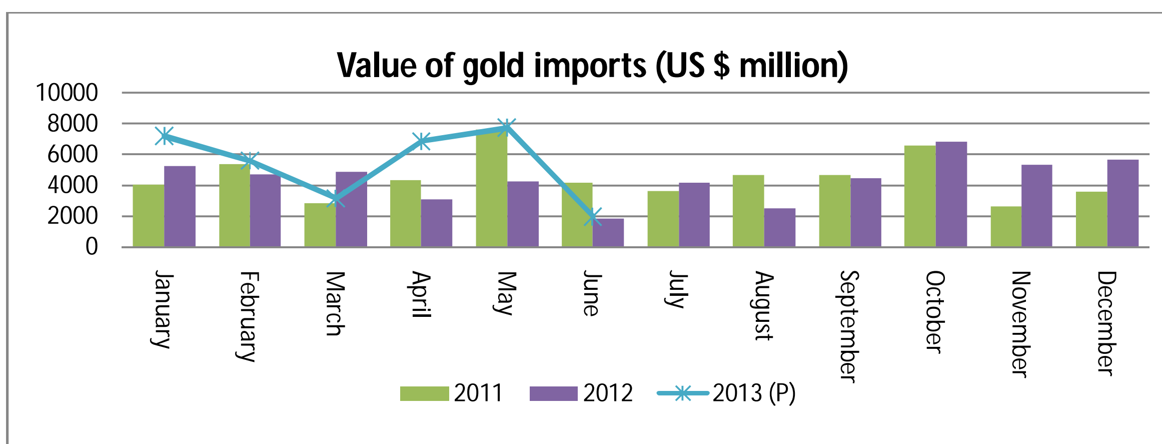
A study by Commission for Agricultural Costs and Prices (CACP) on this matter calculates that direct transfer of food and fertilizer subsidies in cash to targeted beneficiaries has the potential to save almost USD 11.11 billion.

The DBTwas rolled out in 43 districts in Phase-I. Recently, 78 more districts have been included in Phase-II. DBT now covers 26 schemes. The three Pension Schemes managed by Rural Development (old age, disability and widows) would be introduced from 1st July 2013.

4. External Sector and Trade

The Current Account Deficit (CAD) narrowed to 3.6 per cent of GDP in the January-March quarter from 6.7 per cent in the previous quarter and was financed with strong capital flows. The overall trade deficit for April-June, 2013-14 was estimated at USD 50.18 billion which is higher than the deficit of USD 42.21 billion during the same period in the previous fiscal. The trade deficit shot up on account of relatively lower exports as compared to imports. **The recent volatility and the depreciation of the Indian Rupee has certainly put pressure on the CAD but the Rupee is expected to strengthen from the current levels on account of the domestic policy reforms which is likely to boost domestic and foreign investor sentiment.**

To reduce the CAD, both demand and supply side constraints need to be addressed. On the demand side, there is a need to contain the demand for petroleum products and gold –the two biggest components of our trade deficit. **To tackle the gold imports, government has taken several measures and the graph below depicts a steep decline in the gold imports in June, 2013 (the import duty on gold was hiked from 6 per cent to 8 per cent on June5, 2013.**



Source:DGCI&S

On the petroleum products, the government began the process of correcting petroleum products prices last year. The gradual correction that was put in place for correction of diesel prices had reduced the under -recoveries from almost INR 13 per litre to less than INR 2 per litre.Unfortunately, some of this has been undone by the depreciation of the rupee. However, the policy of adjusting prices to progressively eliminate under-recoveries would continue. Measures have also been put in place to provide an impetus to petroleum and natural gas exploration and coal production which are going to have medium to long term benefits on CAD.

On the supply front, there is a need to push our exports, bring in long term investment and get the manufacturing cycle going. Government is seized of the matter and is taking measures to address the supply side constraints. **Recently, the Prime Minister chaired a High Level Committee on Manufacturing where it was emphasized to make manufacturing as the backbone of our growth strategy in the next decade. With a view to ease the process of FDI inflow in the country, the Arvind Mayaram Committee Report to liberalize the FDI Policy is under consideration of the government. The recent Foreign Trade Policy (2009-14) has several measures which are likely to provide fillip to our exports.**

5. Capital Markets:

The Government has made concerted efforts to attract greater investments in the Indian capital market.

A number of important reform initiatives have been taken in the recent times with the aim to improve efficiency and depth in the operation of trading system, in production of new instruments, reduction in transaction costs, improvement in clearing, settlement and disclosure practices, greater participation of a wide range of investor classes and strengthening of the regulatory and institutional framework.

Recent Reform Initiatives

- **To permit insurance companies, provident funds and pension funds to trade directly in the debt segment, the amendments to the Securities Contracts Regulation Rules, 1957 are underway.**

- **Investor Protection Fund set up by a depository for the protection of interest of beneficial owners has been exempted from income tax.**

- **Securities Transaction Tax (STT) has been reduced for equity futures from 0.017 per cent to 0.01 per cent and for Exchange Trading Funds (ETFs) and Mutual Funds on the exchange platform from 0.1 per cent to 0.001 per cent and those at fund counters from 0.25 per cent to 0.001 per cent.**

- **FIIs have been permitted to use their investment in corporate bonds and Government Securities as collateral to meet their margin requirements.**

- **Pursuant to the budget announcement 2013-14, a Standing Council of Experts on the Indian Financial Sector has been constituted by the Ministry of Finance, Government of India with a view to assess the international competitiveness of the Indian financial sector.**

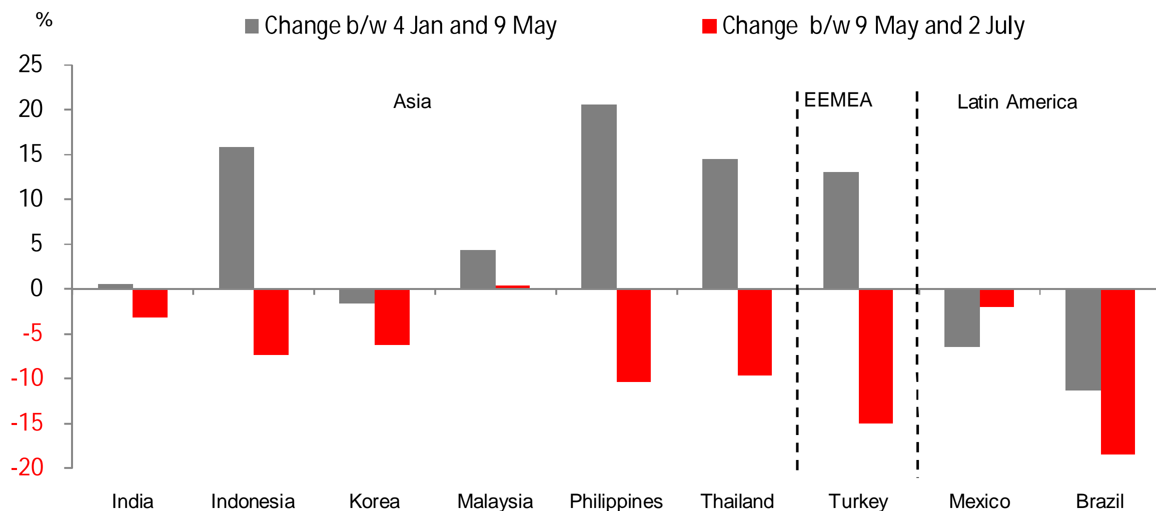
- **The Government of India has enhanced the Government Debt Limits by USD 5 billion. Enhanced limit shall be available for investments only to those FIIs which are registered with SEBI under the categories of Sovereign West Funds, Multilateral Agencies, Endowment Funds, Insurance Funds, Pension Funds and Foreign Central Banks.**

- **The Cabinet approved the promulgation of an Ordinance to amend the Securities and Exchange Board of India (SEBI) Act and related Acts which would provide more powers to the capital markets regulator for enforcement against illegal Collective Investment Schemes and to curb insider trading.**

Recent Volatility in the forex markets

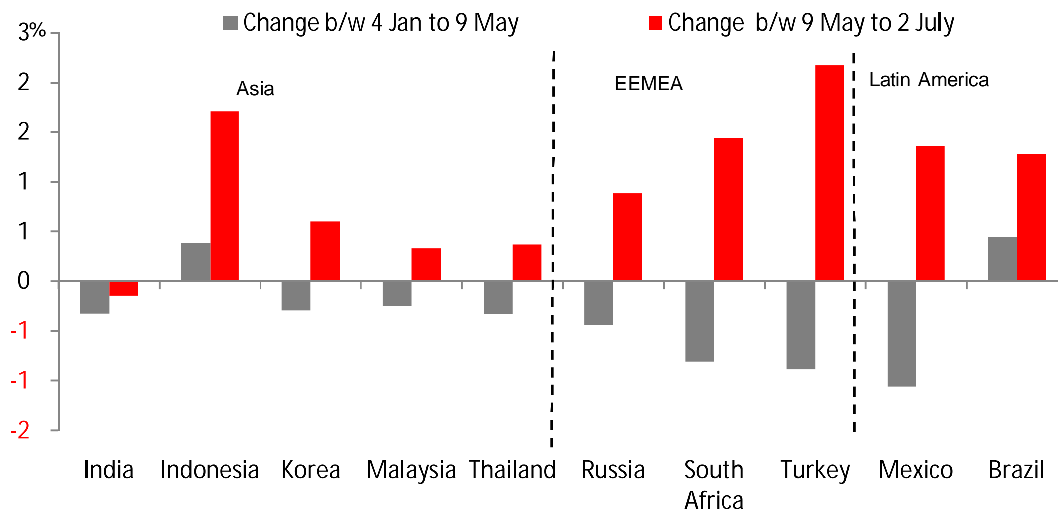
Much of the recent volatility in the forex markets was due to the global markets reacting to the likelihood withdrawal of Quantitative Easing (QE) by the US Fed Reserve Bank. Large volume of funds were withdrawn from Emerging Market Economies (EMEs) and a depreciation was hence witnessed in many EME currencies. The economies running a large current account deficit saw a greater depreciation, apart from the Indian Rupee, South African Rand, Brazilian Real, Turkish Lira and Mexican Peso have seen declines.

Equity Markets Indexes



Source: Bloomberg

EM exchange rate against the USD



Source:Bloomberg

The recent measures taken by the Reserve Bank of India do not aim at increasing the long term interest rates. The steps have been taken to curb the speculative pressure on the INR.

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