India Macro Newsletter

May, 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. In the industrial sector, although the IIP decelerated to 2.3 per cent in April after picking up in the preceding month, the growth in the consumer non-durables continued to be strong .On investments, the government has taken several important steps to kick-start the investment cycle such as clearing big-ticket projects through the Cabinet Committee on Investments (CCI) channel and providing investment sops in the budget. The services sector Purchasing Manager's Index (PMI) rose in May on order flows. 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.* ***(page 2)***

- ***Inflation –*** *Inflation has been declining across its different measures – Wholesale Price Index (WPI) inflation, Consumer Price Index (CPI) inflation and Purchasing Managers Index (PMI) input and output prices. WPI fell to 4.7 per cent in May, 2013. The non-food manufacturing component of the WPI, has fallen to a 41 month low of 2.4 per cent in May, 2013. After remaining elevated for several months, CPI inflation has moderated over April and May, and is likely to fall further over the next few months.* ***(page 5)***

- ***Fiscal Performance*** *–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. This is expected to come from higher tax surcharges, a one-time voluntary compliance scheme for service tax dues, increase in indirect tax on select goods and revenues from disinvestments and spectrum sales. On expenditure side, substantial savings are expected from cutting the subsidy bill, especially fuel subsidy. The split of expenditure has moved from non-plan towards the more growth enhancing plan expenditure.*

(page 6)

- ***External Sector and Trade –*** *India's May trade deficit widened to USD 20.1 billion from USD 17.8 billion a month ago. Overall trade deficit for April-May, 2013-14 was estimated at USD 37.9 billion which is higher than the deficit of USD 30.97 billion during the same period in the previous fiscal. The trade deficit shot up on account of relatively lower exports as compared to imports. India's Foreign Exchange Reserves stood at USD 287.9 billion in end of May, 2013 and CAD was fully financed by the capital flows. Further, the Government is seized of the matter and is taking concrete measures to reduce the Current Account Deficit.* ***(page 7)***

- ***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.* ***(page 8)***

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 Ms Pranjul Bhandari who is now headed to Harvard University as a Mason fellow.

1. GDP Growth

According to the OECD's latest Economic Outlook, global economy is moving forward, but divergence between countries and regions reflects the uneven progress made towards recovering from the economic crisis. The United States is likely to grow faster than the other large OECD economies. The euro area growth remains constrained by the lingering effects of the euro area crisis, the ongoing drag from fiscal consolidation and weakness in credit markets. Japan is on the road to recovery this year. In the key emerging market economies, China remains the main driver yet again expected to lead the growth.

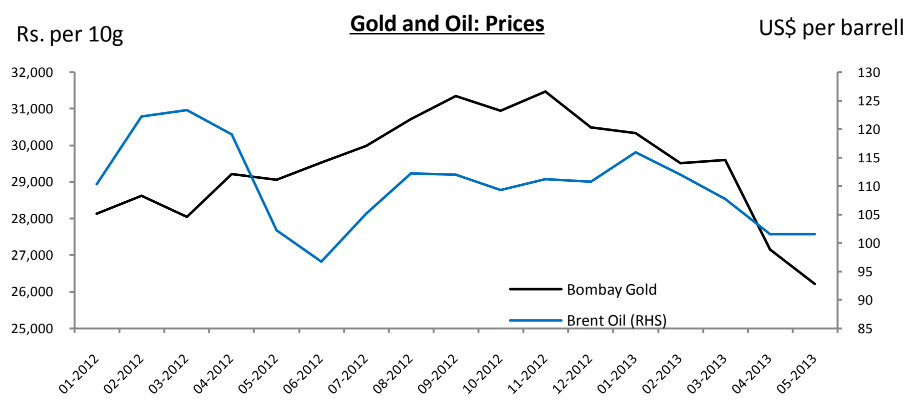
India's outlook was revised to stable by Fitch Ratings.

The Outlook was revised keeping into consideration, broadly ,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.



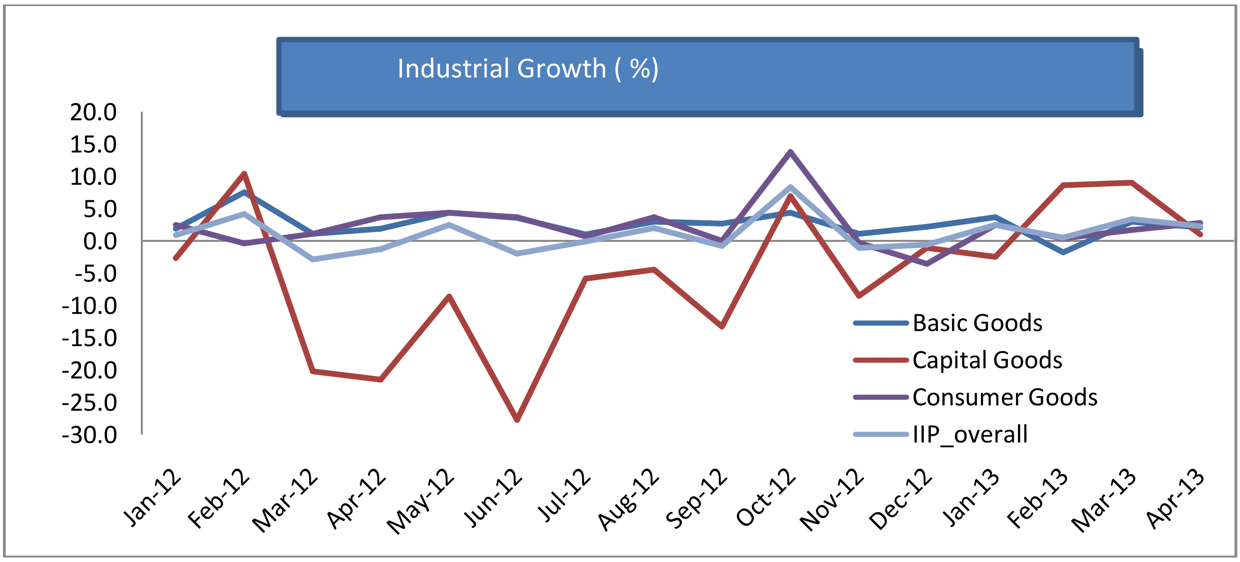
Source:CEIC

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.

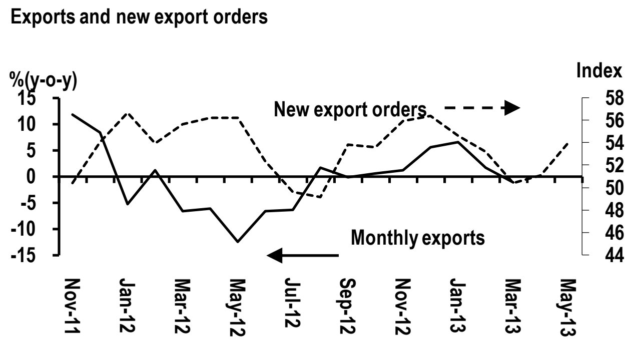
ii. **The Index of Industrial Production (IIP) slowed to 2.3 per cent (year-on-year) during April. However, consumer goods output grew in May added by a sharp pick-up in output of consumer non-durables which recorded growth of 12.3 per cent in April, 2013 over the corresponding period in last year. The consumer durables output continued to decline for the fifth consecutive month**.

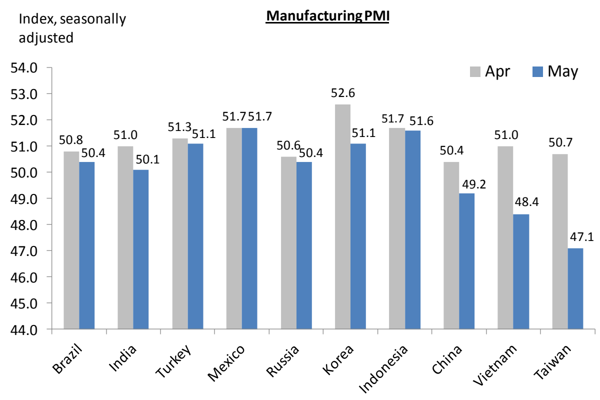


Source:CSO

iii. HSBC Emerging Market Index (EMI) remained unchanged from April at 51.4 in May. That was the joint – lowest level witnessed since September, 2011 and indicated a muted rise in global emerging market output. Growth slowed in China, Brazil and Russia but accelerated slightly in India on the back of a stronger service performance. The **India PMI Services output** index rose to 53.6 in May from 50.7 in April.

iv. The seasonally adjusted HSBC **Purchasing Managers Index (PMI)** which is a composite indicator of manufacturing moderated to 50.1 during May, 2013but **continues to be in the expansionary territory.** The **new export orders** index of the manufacturing PMI rose sharply to 54 in May from 51.1 in April.





Source: Markit Economics

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 the last meeting which was held on May 23, 2013 the CCI took up the matters related to the Security Clearances for PPP projects in major ports and also reviewed the progress made in resolution of bottlenecks in implementation of the highway projects. 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.

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)** are expected to spur investments in due course of time .

The Delhi Mumbai Industrial Corridor, a project with Japanese collaboration entailing over USD 90 billion in investment, linking Delhi to Mumbai's ports, covering 1483 kms and passing through six States, is underway. This project will have nine mega industrial zones, high speed freight lines, three ports, six airports, a six-lane intersection-free expressway connecting the country's political and financial capitals, and a 4000 MW power plant. Such projects offer excellent investment opportunities in the area of infrastructure development and manufacturing.

2. Inflation

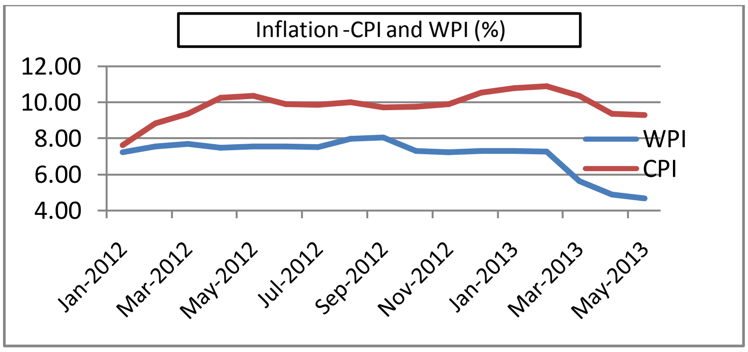
All measures of inflation – the Wholesale Price Index (WPI), Consumer Price Index (CPI) and PMI Manufacturing Input and Output Price Indices – suggest unanimously that the price pressures are declining.

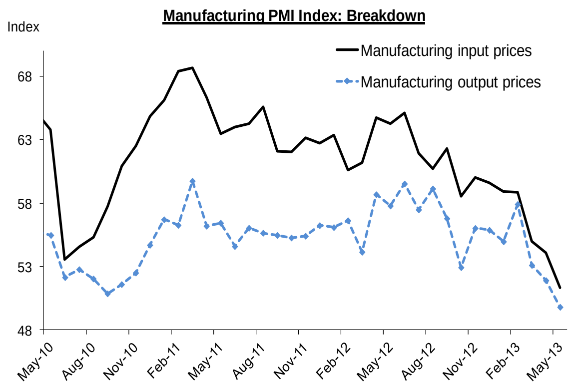
After remaining in an elevated territory of over 9 per cent during 2011-12, **the headline WPI inflation has fallen significantly to 4.7 per cent in May, 2013 from previous month's level of 4.89 per cent.** The RBI's preferred measure of **core inflation, (measured as non-food manufacturing inflation), has fallen to a 41-month low** of 2.4 per cent in May, 2013. After remaining elevated for several months, the **Consumer Price Index (CPI)** (Base: 2010=100) fell for a third consecutive month and **has moderated to** 9.31 per cent in its latest May 2013 reading. The RBI in its Annual Monetary Policy has projected an average inflation of 5.5 per

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.

Finally, **the Manufacturing PMI input and output prices have also shown big declines** recently.





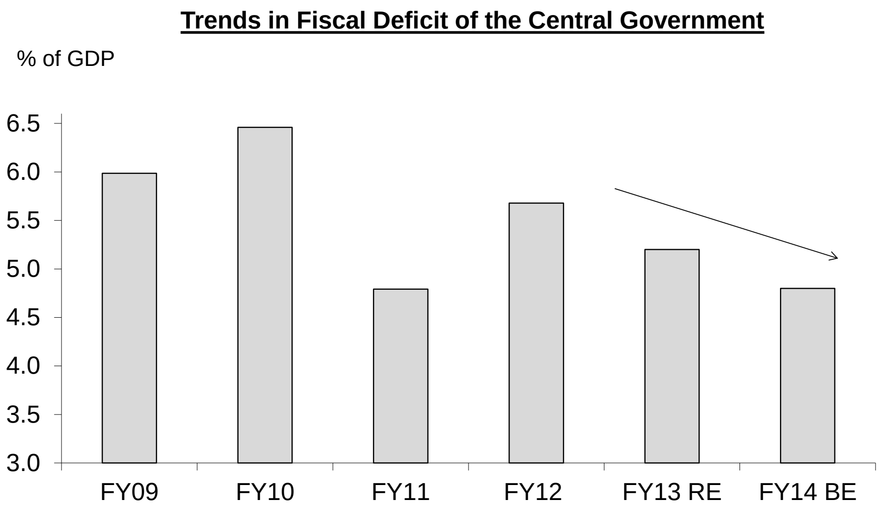
Source:CEIC,RBI

The RBI in its mid-quarter review of monetary policy kept the interest rates unchanged. The RBI's stance to keep the interest rates unchanged perhaps was influenced by the recent developments in the external sector particularly the movement in the exchange rate.

Inflation Index Bonds (IIBs)
Pursuant to the Budget announcement, Government in consultation with the RBI has launched Inflation Index Bonds (IIBs), as instruments that aim at protecting savings of the 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.



Source: CGA

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.** 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.

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.

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

The DBT was 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

- India's May trade deficit widened to USD 20.1 billion from USD 17.8 billion a month ago. Overall trade deficit for April-May, 2013-14 was estimated at USD 37.9 billion which is higher than the deficit of USD 30.97 billion during the same period in the previous fiscal. The trade deficit shot up on account of relatively lower exports as compared to imports, surge in festival related/ seasonal gold imports. However, available evidence suggests that a moderation in gold imports could be underway in June, 2013.

- India's Foreign Exchange Reserves stood at USD 287.9 billion in end of May, 2013 and CAD was fully financed by the capital flows. **Looking ahead moderation in the CAD is expected due to (i) lower import of** gold, softening of international crude oil prices and other imports which have seen a decline (ii) moderate improvement in exports over the last few months (iii) fall in the international gold prices and reduction of subsidies on the petroleum products.

- The Government is also taking concrete measures to reduce the CAD. Fiscal consolidation roadmap adopted by the Government would help. **Some of the other measures include:**
  - **To reduce the gold demand, the import duty on gold was increased from 6 per cent to 8 per cent with effect from June 5, 2013.**
  - **Introduction of Inflation Indexed Bonds.**
  - **To attract long term investment into the country, the Government is looking at revising the extant FDI Policy where the focus would be to ease the process of FDI inflow and liberalizing the limits and caps.**
  - **Steps to provide impetus to petroleum and natural gas exploration and coal production-this is expected to have medium term benefits on CAD.**
  - **The recent Foreign Trade Policy (2009-14) contained several measures to provide a fillip to the exports.**
  - **Rationalization of petroleum subsidies.**

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 Volatility in the Asian Market Currencies

Anticipation of QE draw down indications from the US Fed and an improvement in the US economy weighed on market sentiments and resulted in a pull out by the investors from the emerging markets. The reversal of the cash that flowed in the emerging markets in the last few years resulted in a sharp fall in the currencies of the emerging markets. The economies running a large current account deficit have seen a greater depreciation in their currencies, apart from the Indian Rupee, South African Rand, Brazilian Real and Mexican Peso have also seen declines.

Recent Reform Initiatives

- **To permit insurance companies, provident funds and pension funds to trade directly in the debt segment (with the approval of the sectoral regulator), 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 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 Wealth Funds, Multilateral Agencies, Endowment Funds, Insurance Funds, Pension Funds and Foreign Central Banks.**

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