India Macro Newsletter

January 2013

I. Macro Economic Review

- ***GDP Growth –*** *On the real economy, growth in several activity indicators has risen since the first half of 2012-13, though recovery is still at a nascent stage and investments need to revive. Sentiments have improved as reflected in business surveys and FII inflows. The Rupee, which was sluggish over several months, has appreciated quickly by 2.5 per cent since January 18th when the announcement to increase diesel prices by about 50 paise a month was made.* ***(page 2)***

- ***Inflation –*** *Headline WPI inflation softened for a third month in a row to 7.18 per cent y-o-y in December, 2012 and RBI's core inflation fell further to 4.2 per cent. On the other hand, CPI inflation rose to 10.6 per cent, mostly due to higher food and fuel prices. The moderation in inflation provided the RBI some space, though limited, to reduce the policy rates. A reduction in the policy rates is expected to improve liquidity conditions to support credit flow and support growth by encouraging investments.* ***(page 5)***

- ***Fiscal Performance*** *– The Central fiscal balance turned positive in December, 2012 partly due to seasonal trends but also because on a seasonally adjusted basis, tax revenues have been improving and expenditure has been falling over the last few months. The Government is confident of meeting the fiscal deficit target of 5.3 per cent this year.* ***(page 6)***

- ***External Sector and Trade –*** *The high Current Account Deficit is a cause of concern for the Government. The worsening of CAD has been primarily on account of higher gold and petroleum imports. To curb the gold imports, the Finance Minister had recently announced that the banks will come up with innovative gold products which will channelize household cash. Import duty for gold has been raised from 4 per cent to 6 per cent as an immediate step to arrest gold imports. Looking ahead into 2013, there are indications that exports growth may improve, providing support to the Current Account.* ***(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 both in terms of portfolio investments and direct investment. The FIIs invested USD 31 billion in the calendar year 2012.* ***(page 8)***

II. Recent Reform Measures-

The government has taken several important steps over the last few months which have increased optimism in the economy. The measures range from announcing a roadmap for fiscal consolidation, setting up the Cabinet Committee on Investment (CCI) to fast track mega projects, postponing the General Anti Avoidance Rules (GAAR) by two years, rationalization of diesel prices, passing of some key Bills, allowing FDI in multi brand retail and other sectors, launching of Aadhar based direct cash transfers, etc. ***(page 9)***

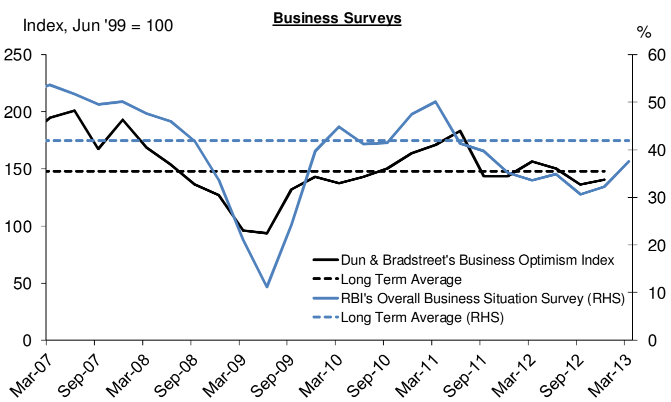
This review has been put together by Ms Pranjul Bhandari, Economist, Office of the Chief Economic Adviser and Ms Archana Naresh, OSD to Secretary, Economic Affairs. We would like to thank Dr. Arvind Mayaram, Secretary, Economic Affairs and Dr. Raghuram Rajan, Chief Economic Adviser, for their comments and valuable suggestions.

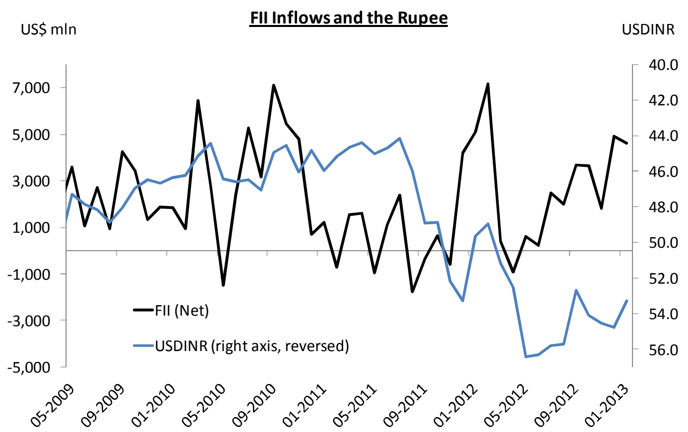
1. GDP Growth

The Central Statistics Office (CSO) has released the advance estimates of GDP for the year 2012-13 and India's GDP growth has been pegged at 5.0 per cent. It is pertinent to point out that this is only an advance estimates, following a forecast technique that does not capture upturns. The actual number for growth rate is yet to be released. On the other hand, RBI in its third quarterly review released on January 28, 2013 projected a growth rate of 5.5 per cent. The growth projection by some independent agencies is also in sync with the RBI's projections.

Forecasts GDP Growth	2012-13	2013-14
Citibank	5.4	6.2
Nomura	5.5	6.2
BoA/ML	5.5	6.5
JP Morgan	5.2	5.8
Morgan Stanley	5.4	6.2
Deutsche Bank	5.5	6.5
Average	**5.4**	**6.2**

A modest recovery is expected to set in from Q4 of 2012-13 as reforms and efforts to remove structural constraints get underway. Sentiments have improved over the last few months, as reflected in business optimism surveys and increasing FII inflows. **The rupee has seen an appreciation of 2.5 per cent since January 18, 2013, when the announcement to increase diesel prices in a phased manner of about 50 paise per month, was made.**





Source: RBI, SEBI, CEIC

On the real economy front, activity indicators seem better than they were in the first half of 2012-13, despite a few festival demand induced upticks showing some reversal.

Current trends across sectors are discussed below –

i. Agriculture - Winter Rabi cropping has picked up after a late start caused by a delayed Kharif harvest.

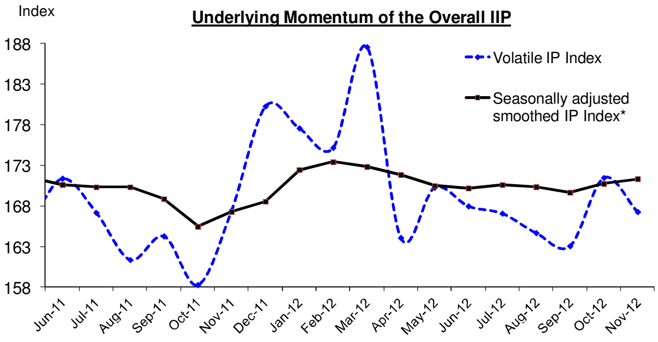
- Sowing of **wheat, the principal Rabi crop, has almost reached last year's bumper crop levels.** Pulses cropping has also almost reached last year's levels from being down 6 per cent yoy in November. Oilseed farmland is up 2.2 per cent yoy.
- **Good water levels are also likely to improve crop yields.** The major reservoirs of the country are filled 8 per cent above their long-term water levels.
- While October-December, 2012, agricultural GDP is likely to remain depressed due to poor monsoons of 2012, expectations of an improved Rabi crop is likely to show up in the January-March, 2013, and April-June, 2013, quarters.

Area in mn hectare	FY13 ytd	FY12 ytd	% yoy	Normal Area
Wheat	295	296	-0.3	283
Rice	9	10	-16.2	45
Coarse Cereals	61	58	3.7	63
Gram	92	89	3.4	81
Pulses	142	143	-0.6	127
Rapeseed & Mustard	67	65	2.8	63
Oilseeds	85	84	2.2	92
Total Rabi Area	592	592	0.1	610

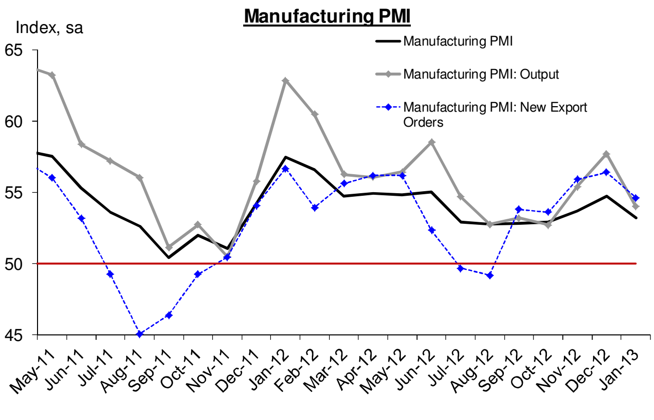
Source: Ministry of Agriculture

ii. Industrial growth is better than in the first half of 2012-13

- While November IIP decelerated 0.1% yoy, it was due to a high base. Smoothening out of the volatile index over the past few months points to a pick up, though the recovery is still at a nascent stage.



Note: The original IP Index is very volatile. To read through the noise, we first seasonally adjust the series and then take a 3-month moving average



Source: CEIC, Markit Economics

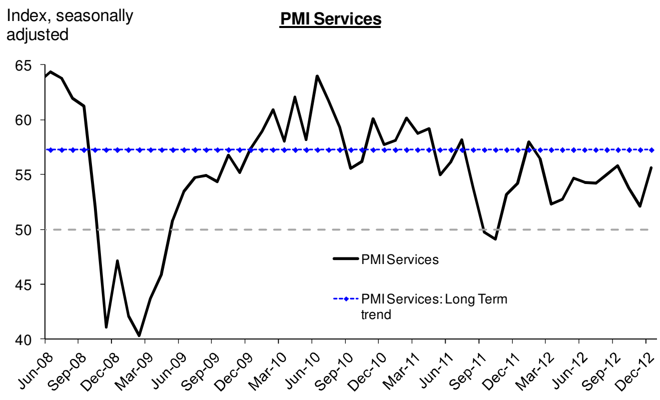
- **The Purchasing Managers Index (PMI) has improved since September, indicating a bottoming out of manufacturing activity.** After increasing for three consecutive months, the PMI Index moderated slightly to 53.2 in January from 54.7 in December. However it is well above the expansion threshold of 50.

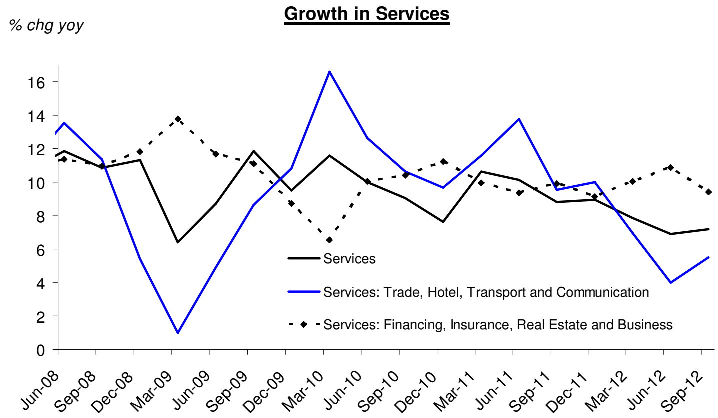
- The difference in the IIP and PMI arises on account of the difference in the basket composition and methodology. Lately though, both are giving consistent messages of industrial activity having bottomed out.

iii. Services have also been growing moderately

- **The PMI service Index rose to a one-year high of 57.5 in January, 2013 from 55.6 in December, and crossed the long term average** of 57.3.

- **From the GDP accounts perspective, yearly growth in services showed a slight increase** to 7.2 per cent y-o- y in the July to September,2012 quarter from 6.9 per cent y-o-y in the previous quarter.



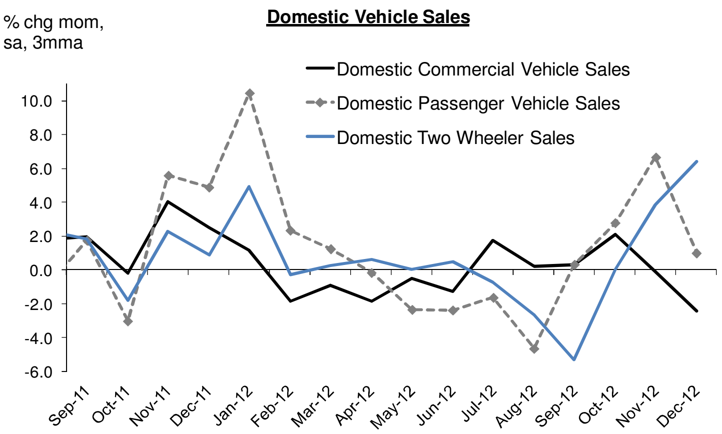


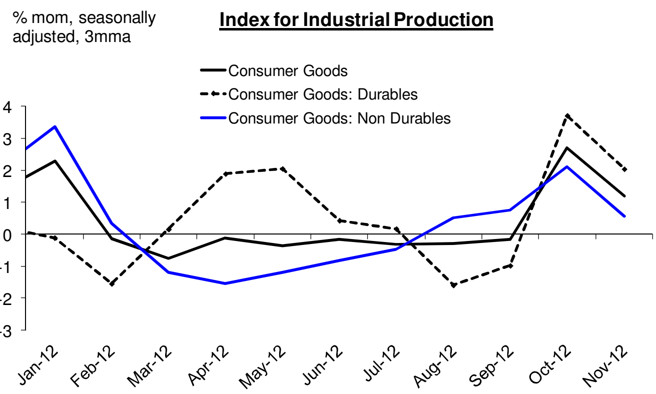
Source: Markit Economics, CSO, CEIC

iv. Investments remain depressed but the recent measures announced by the Government are expected to revive the sector. Setting of the **Cabinet Committee on Investment (CCI)** under the Chairmanship of the Prime Minister to fast track big projects has found wide acceptance amongst the investors. The other major initiatives taken by the Government such as **liberalization of FDI in retail, aviation, insurance and broadcasting, deferment of general anti-avoidance rules (GAAR), relaxation in ECB guidelines, launch of Infrastructure Debt Funds (IDFs)** have also significantly lifted the market sentiment , which in due course of time should spur investment.

v. The festival induced spurt in consumption is wearing off but indicators are looking better than in the first half of 2012-13. After showing an increase over October and November, 2012, growth in passenger vehicles sold has moderated in December, 2012. While the trends in IIP consumption goods, both durable and non-durables, are better than in the first half of 2012, they have shown a slight decline in the post-festival November, 2012 reading.

It is interesting to note that strong domestic demand, on account of growing rural incomes and rise of urban middle class, played an instrumental role in keeping the growth momentum relatively high in India, despite a global slowdown. India's household final consumption is a healthy 57 per cent of GDP.





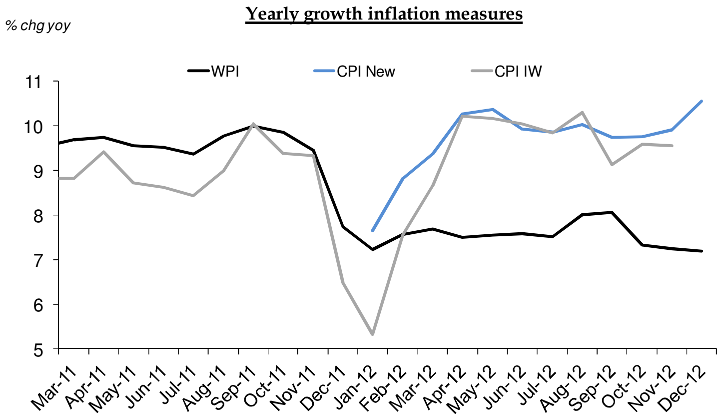
Source: CSO, CEIC

2. Inflation and Monetary Policy

WPI inflation which averaged 9.56 per cent in the year 2010-11 moderated to 8.94 per cent in the year 2011-12 and further decelerated to 7.55 per cent during April-December, 2012, showing a falling trend.

In its latest reading, WPI inflation moderated to 7.18 per cent in December, 2012, from 7.24 per cent in November, 2012 despite a low base. RBI's preferred indicator of core inflation also moderated to 4.24 per cent.

On the other hand, inflation based on the new combined (rural and urban) Consumer Price Index (CPI) (Base: 2010=100) rose to 10.6 per cent in December, 2012 as compared to 9.9 per cent in November, 2012 largely reflecting an increase in food and fuel inflation. Looking ahead, food inflation could moderate on the back of a good Rabi crop.

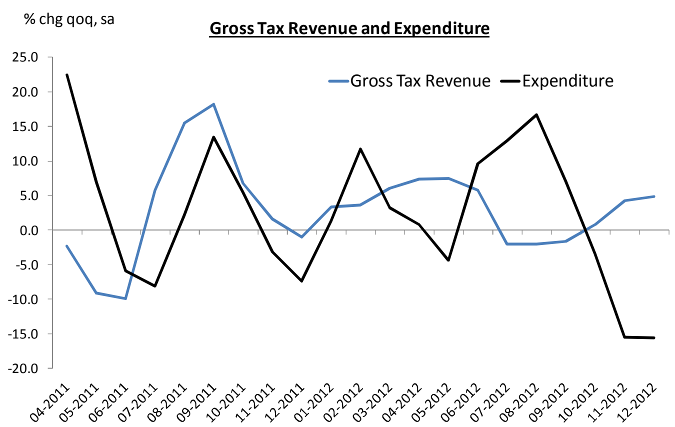


Source: CSO, CEIC

In its Third Quarter Review of Monetary Policy (2012-13) released on January 29, 2013, the RBI reduced the benchmark policy rates. The Repo rate was cut by 25 basis points to 7.75 per cent and the Cash Reserve Ratio was cut by 25 basis points to 4 per cent. This reduction in CRR is expected to inject Rs 180 billion of primary liquidity into the banking system. The moderation in the headline inflation provided the Central Bank a limited space for monetary policy to give greater emphasis to growth risks. The policy actions are expected to improve liquidity conditions and support credit flow and growth.

3. Fiscal Performance

The Central fiscal balance turned positive in December. On a seasonally adjusted basis, tax revenues have been improving and expenditure has been falling since September 2012.



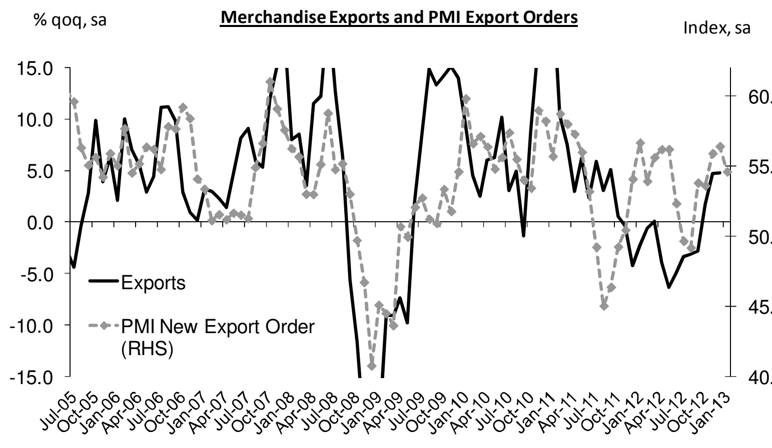
Source: CGA, CEIC

The Government is confident of meeting its fiscal deficit target of 5.3 per cent this year. It has taken several measures towards fiscal consolidation, such as **rationalization of diesel prices and plan and non-plan expenditure, launch of Aadhar enabled service delivery system of cash transfer** to plug the leakages in the present method of indirect subsidies, divestment of public sector enterprises, etc. The government is also making concerted efforts to introduce the **Goods and Services Tax (GST)** at the earliest. The government plans to bring its fiscal deficit down to 4.8 per cent in the next fiscal and then reduce the deficit by 0.6 percentage points every year to 3 per cent in the year 2016-17.

4. External Sector and Trade

The high Current Account Deficit (CAD) is a cause of concern for the Government. The worsening of CAD has been primarily on account of higher gold and petroleum imports. To curb the gold imports, the Finance Minister had recently announced that the banks would soon come up with various **innovative gold products** which could channelize the future demand for gold to institutionalized schemes. The **import duty was raised from 4 per cent to 6 per cent** as an immediate step to arrest the gold imports. **The reduction of subsidies on petroleum products** will help reduce import demand. The government has **opened up FDI in various sectors** which is seen as a safer way of financing the CAD.

In the medium term, a **revival in export growth** will help significantly. **The outlook for 2013 exports has improved.** A rise in exports has already led to a small improvement in the trade deficit in November and December, 2012. India's PMI New Export Orders has been over 50 for five consecutive months suggesting that exports could continue to improve. Trade flows in the region (e.g. Korea's January exports) have also been looking up.



Source: CSO, CEIC

The Rupee has seen an appreciation of 2.5 per cent since January 18, 2013. An appreciation in the exchange rate is expected to increase the value of GDP in dollars which will have a positive impact on the Current Account Deficit (as a percentage of GDP).

5. Capital Markets:

Several measures have been taken by the government to encourage the availability of foreign funds for financing infrastructure such as relaxation of ECB guidelines, launch of tax free bonds, long term infrastructure bonds, etc. Measures have also been taken by Securities and Exchange Board of India (SEBI) and the Reserve Bank of India (RBI) to remove regulatory hurdles and promote growth of corporate bond market in India. These measures are largely aimed at simplification in procedures and processes such as simplified disclosure norms, easier investment regime for institutional investors, simplifying the process of foreign investments in corporate debt, etc.

II. Recent Reform Measures

Some reform measures taken by the Government over the last several months are the following:-

I. Bills passed

a) The Banking Laws (Amendment) Bill 2011

The Bill was introduced in order to amend the Banking Regulation Act, 1949, the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970/1980. The said Bill has been passed by both the Houses of Parliament during its just concluded Winter Session. This Bill would strengthen the regulatory powers of Reserve Bank of India (RBI) and further develop the banking sector in India. It will also enable the nationalized banks to raise capital by issue of preference shares or rights issue or issue of bonus shares. The Bill would also pave the way for new bank licenses by RBI resulting in opening of new banks and branches.

b) Passing of the new Companies Bill by the Lok Sabha:

The Companies Bill, 2011 was passed by the Lok Sabha on 18th December 2012. On its enactment this new Companies law will allow the country to have a modern legislation for growth and regulation of corporate sector in India.

c) Competition Commission of India (Amendment) Bill 2012:

The year also saw the *introduction* of a Bill in the Lok Sabha on 7th December 2012 by the Ministry of Corporate Affairs to further amend the Competition Act, 2002, with a view to fine tune it and to meet the present day needs in the field of competition, in the light of the experiences gained in the actual working of the Competition Commission of India in the last few years.

II. Foreign Direct Investment (FDI):

The Government on September 20, 2012 notified the Cabinet/CCEA decisions on

a) FDI in single brand retail, for instance, IKEA, a Swedish company which has been allowed to invest in the country.
b) Multi brand retail,
c) Civil aviation,
d) Broadcasting sector and
e) Power exchanges.

III. Disinvestment:

The Cabinet Committee on Economic Affairs (CCEA) has approved the disinvestment in the following:-

a) Disinvestment of 9.33 per cent paid up equity of MMTC Ltd. out of the Government of India's holding of 99.33 per cent through an Offer for Sale of Shares through Stock Exchanges, as per SEBI Rules and Regulations.
b) Disinvestment of 10 percent paid up equity of Oil India Ltd. (OIL) out of the Government of India's holding of 78.43 percent through an offer for sale of shares through stock exchanges as per SEBI rules and regulations.
c) Disinvestment of 12.15 per cent Paid Up Equity in National Aluminium Company Limited.
d) Disinvestment of 9.59 per cent Equity in Hindustan Copper Limited.
e) Disinvestment of 9.50 per cent paid up equity capital in NTPC Limited out of Government of India's shareholding of 84.50 per cent. The Cabinet Committee on Economic Affairs has approved disinvestment of 9.50 per cent equity of NTPC Ltd., out of its holding of 84.50 per cent through an offer for sale of Shares through Stock Exchanges as per SEBI Rules and Regulations.
f) Exchange Traded Fund (ETF) for the stocks of the listed Central Public Sector Enterprises (CPSEs) is also being proposed.

IV. National Policy on Information Technology:

The Cabinet has recently approved the National Policy on Information Technology 2012. The Policy aims to leverage Information & Communication Technology (ICT) to address the country's economic and developmental challenges. The policy is rooted in the conviction that ICT has the power to transform the lives of people.

V. Withholding Tax on Foreign Loans:

In order to enable low cost foreign borrowings by the Indian companies, the Finance Act, 2012 amended the Income-tax Act to lower the tax on such borrowings. The interest income of a non-resident investor will be taxed at the reduced rate of 5 per cent instead of the existing rate of 20 per cent. Further, the liability of the Indian company to withhold tax on such income would also be at the reduced rate of 5 per cent. This lower rate of taxation will apply to interest paid to a non-resident by an Indian company for money borrowed in foreign currency from a source outside India either under a loan agreement or by way of long-term infrastructure bonds.

VI. Fiscal Measures: Some of the fiscal measures are as follows:-

i) Government is continuously monitoring the emerging economic developments and the fiscal position. Government appointed a committee headed by Dr. Vijay L Kelkar to suggest roadmap for fiscal consolidation. Government has broadly accepted its recommendation.

ii) Government has announced the roadmap for fiscal consolidation by containing current year's fiscal deficit at 5.3 per cent of the GDP and reducing it to 4.8 per cent next year. The fiscal deficit is targeted to be reduced by 0.6 percentage points each year thereafter (till 2016-17), at 4.2%, 3.6% and 3.0% in the years 2014-15, 2015-16 and 2016-17 respectively.

iii) To contain the increasing Subsidy burden, Government has rationalized diesel prices, announced a roadmap for increasing diesel prices by about 50 paise per month and capped subsidized LPG cylinders to consumers. Government has also initiated reforms to boost investment.

iv) Government is taking various steps to boost revenues and limit any slippage there from. The reserve price of 2G telecom Spectrum auction has been revised and a fresh auction would be held soon and efforts are there to expedite the plan for divestment.

v) Government has imposed economy measures like rationalization of expenditure and optimization of available resources with a view to improve the macro-economic environment. This includes 10 per cent mandatory cut on Non-Plan expenditure in the current financial year. The measures on the expenditure side would partially offset the higher than budgeted outgo on subsidies and the slippage in non-debt receipts.

VII. Investment : Some measures include the following:

a) The Cabinet Committee on Infrastructure on 13.12.2012 approved the proposal of enhancing Ceiling of 4,000 km of four laning in NHDP Phase-IV to 8000 km.

b) First phase of 2G auctions have been carried out.

c) The Cabinet Committee on Investment (CCI) headed by the Prime Minister has been established, to fast track mega projects of over Rs.1,000 crores.

d) Scheme for Financial Restructuring of State Distribution Companies: In an attempt to restore power purchasing capacity of the debt ridden DISCOMS and also to enable Banks to recover their loans, the Cabinet Committee on Economic Affairs approved the scheme for Financial Restructuring of State Distribution Companies (Discoms). The scheme contains various measures required to be taken by State Discoms and State Governments for achieving the financial turnaround of the Discoms by restructuring their debt with support through a Transitional Finance Mechanism by Central Government.

VIII. Subsidies: Diesel and LPG prices have been rationalized. Furthermore, a roadmap for increasing diesel price by about 50 paise a month has been announced. Pilots for Aadhar enabled Direct Cash Transfers have been started.

This review has been put together by Ms Pranjul Bhandari, Economist, Office of the Chief Economic Adviser and Ms Archana Naresh, OSD to Secretary, Economic Affairs. We would like to thank Dr. Arvind Mayaram, Secretary, Economic Affairs and Dr. Raghuram Rajan, Chief Economic Adviser, for their comments and valuable suggestions.