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INDIAN ECONOMY

CRISIL Insights

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Through the monthly CRISIL Insights Indian Economy series, we offer incisive analysis of macroeconomic parameters of the country. In this issue, we highlight some structural issues that plague the rural, specifically agrarian, economy and suggest solutions

Rx for rural

India's rural economy has a huge footprint, supporting 70% of its population and accounting for almost half of India's gross domestic product (GDP) and private consumption. The recent rise in rural distress, therefore, rightly set off caution lights in the corridors of power. As for rural output, ~40% is from agriculture. Interestingly, this time around, farm stress has little to do with monsoon (normal or near-normal as they were in 2016 and 2017). but more to do with income. Despite a good harvest, farmers did not get remunerative prices for their produce. Even today, many crops are being sold below the cost of production. Sluggish rural wages and sub-normal performance of the construction sector (a key, low-skill-labor absorbing activity), too, hurt non-agricultural rural activity and income. Such a backdrop generally would worry any government, more so in a pre-election year. Three things the Union Budget can focus on are:

- While continuing with the Mahatma Gandhi National Rural Employment Guarantee Scheme, the focus should shift to boosting spending on the construction sector. Higher allocation and steps to boost the sector (rural roads, low-cost housing) are needed because it has the highest employment intensity after agriculture. It employs more workers than even manufacturing. About two-third of the labor force used in construction is unskilled or semi-skilled, which is a key characteristic of people migrating from agriculture, so it's a synergistic rub-off. This will act as a buffer in two ways: if monsoon underperforms this year, such jobs will offer an offset, and if normal, will boost consumption
- Introducing flexible trade policy for timely intervention and ensuring that import prices do not fall below minimum support prices
- Stepping up procurement of non-cereal crops and supporting development of farmer producer organizations to reduce the hold of middlemen

From a medium- to long-term perspective, development of market infrastructure and the futures market, step-up in public investment in irrigation, effective insurance schemes, mechanism to reduce price volatility in perishable crops, and dissemination of knowledge to improve farmers' decision making ability would go a long way in strengthening the agricultural economy as well as enhancing farmer income.

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Money and Banking	Industrial Production	Inflation
Market interest rates firm up	Big surge in IIP	Inflation measures diverge in December

MONEY AND BANKING

- The Reserve Bank of India's (RBI) Monetary Policy Committee (MPC) kept the policy rate unchanged in its December review and maintained its neutral monetary policy stance, but raised concern on rising inflation
- Excess liquidity in the system continue to reduce, led by RBI's liquidity management operations, causing short-term money market rates to firm. Concerns over fiscal woes coupled with the additional borrowing requirement announced by the central government, jerked up yields
- The RBI released it half-yearly financial stability report in the last week of December, which further heightened concerns on bank asset quality
- Based on credit growth, CRISIL expects banking credit to grow 7-9% this fiscal, supported by improved economic growth and domestic demand, and deposit growth to moderate at 7-9%

INDUSTRIAL PRODUCTION

- Index of Industrial Production (IIP) grew 8.4% in November, up from 2.0% in October, indicative of low base-effect and de-clogging of manufacturing activity after the government simplified the GST refund rules, which led to a surge in exports
- The surge was on account of 10.2% growth in manufacturing activity, the biggest contributor to IIP
- Both consumer and investment oriented manufacturing sectors witnessed improvement
- Purchasing Managers' Index (PMI) too had indicated positive growth in manufacturing activity
- This could be indicative of de-clogging of manufacturing activity after the government simplified Goods and Services Tax (GST) refund rules, which also led to a sharp surge in exports
- According to the use-based classification, all the segments displayed positive growth. Capital goods displayed a high growth of 9.4% despite a high base of last year, suggesting some churn there. Infrastructure and construction goods saw their growth jumping to 13.5% in November, from 5.5% in October. Consumer goods too grew positively with consumer non-durables clocking a 23.1% growth

INFLATION

- Consumer Price Index (CPI)-based inflation darted up to 5.2% in December, from 4.9% in November, despite higher base
- This was driven by (1) vegetables inflation, which eased at the wholesale price level but firmed up at the consumer price level, (2) housing inflation (not tracked under Wholesale Price Index, WPI), which surged reflecting the impact of higher house rent allowances paid to government employees, and (3) inflation in personal care and effects (not measured under the WPI), which rose mainly due to higher taxes on services under the GST regime
- In contrast, WPI inflation tripped on low food and manufactured products' inflation to 3.6%, reversing a four-month run-up
- Rising oil prices continue to fuel WPI inflation woes
- CRISIL maintains the average CPI inflation forecast at 4% for fiscal 2018. Accordingly, we also expect the MPC to keep policy rates on hold for the remainder of this fiscal

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Interest Rate	Rupee	Trade
Yields spike on deficit concerns	Rupee ends 2017 on a high	Exports moderate, oil drives up imports

INTEREST RATE

- Bonds continued to lose their hold on the market, with government security (G-sec) prices sliding as 2017 came to end
- After having breached the psychological 7% mark in November, the 10-year G-sec yield shot to a new high in December. Yield on the 10-year G-sec ended December at 7.33%, up 27 basis points (bps) on-month
- Fiscal slippage concerns given the continuous rise in crude prices, lower-than-expected indirect tax collections in the fiscal, and the announcement of higher borrowings, hardened the yield
- Another headwind came in the shape of rising domestic inflation and international crude prices, sending yields through the roof
- Corporate bond yields rose in tandem, with yield on the 10-year paper moving up 12 bps on-month to 7.72% by December-end. Corporate bond yields on average rose 12 bps on-month to 7.65%
- CRISIL expects the 10-year G-sec yield on the 6.79% 2027 bond to settle ~7.3% by March 2018

RUPEE

- The rupee capped a stellar 2017 in December, appreciating 1% on average on-month and 5.4% on-year to 64.2 against the dollar. This was the highest value since August
- The currency rose despite $500 million net outflows by foreign portfolio investors
- The rupee's value was boosted by a depreciating dollar, which fell 0.2% on-month
- Euro gained the most in 2017, while dollar was among the worst performers
- CRISIL expect the rupee to settle at 65.5 per dollar on average in March 2018

TRADE

- Merchandise export growth slowed to 12.4% on-year in December from 30.5% in November. Import growth, however, increased further to 21.1% from 19.6%. Trade deficit expanded to a three-year high of $14.9 billion from $13.8 billion
- The slowdown in exports was broad-based with top commodities such as engineering goods, petroleum products, and gems & jewelry seeing lower on-year growth compared with November
- Oil imports grew 34.9% as oil prices increased 20.8% on-year to $64.4 per barrel on average. Non-oil imports grew 17.2% on account of gold and precious and semi-precious stones
- In fiscal 2018 so far, imports have grown 23% on-year on average, almost twice the 11.9% growth in exports. While imports are expected to continue rising in the remainder of this fiscal due to higher oil prices, sustained recovery in exports will depend on how soon exporters iron out GST-related creases. These disruptions have especially affected small, unorganized exporters in labor-intensive sectors such as textiles, and dragged India's overall export growth lower than its Asian peers

Source: CRISIL Research

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CRISIL Limited: CRISIL House, Central Avenue, Hiranandani Business Park, Powai, Mumbai – 400076. India
Phone: + 91 22 3342 3000 | Fax: + 91 22 3342 3001 | www.crisil.com

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