INDIAN ECONOMY

CRISIL Insights

September 2017

Through the monthly CRISIL Insights Indian Economy series, we offer incisive analysis of macroeconomic parameters of the country. In this issue, we reassess our growth outlook for fiscal 2018

Firing on consumption cylinder

India's gross domestic product (GDP) growth tumbled to 5.7% in the first quarter of fiscal 2018, slowest since the fourth quarter of fiscal 2013 (4.3%). Growth could have been even slower, had 'valuables' not printed unusually high in the first quarter. Growth was on the slide even before demonetization happened; that only added fuel to the fire. Construction sector growth declined the most, given that it is heavily cash dependent.

Even as the economy was recovering from the demonetization shock, growth slowed further in the first quarter of fiscal 2018 in anticipation of the Goods and Services Tax (GST) rollout, leading to destocking of inventories and slower production. Significantly, in the absence of an unusually high pace of growth in valuables (205%) in the first quarter, GDP growth could have been way more sluggish. The kick-up in valuables could be attributed to large gold purchases ahead of GST.

We believe the sharp decline in growth in the first quarter is transitory and the economy will grind up over the next few quarters as the impact of demonetization and destocking wears off. But given the sharp slowdown in growth in the first quarter, we estimate this fiscal's growth to be 7%, or 40 basis points (bps) lower than our previous forecast. This forecast implies GDP growth of 7.4% on average in the remaining three quarters. We believe investments will remain subdued as the private sector continues to deleverage, and the government has limited fiscal space and ability to quickly reverse the investment cycle. We foresee growth to essentially be consumption-led with following four drivers:

- Near-normal monsoon. The rains were 6% below normal till September 15. Although some geographies are deficient, they account for only 5% of kharif production. And since sowing has progressed well, we expect agriculture to grow at the trend rate of 3%.
- Softer interest rates and inflation. Demonetization created excess liquidity in the banking system. This has facilitated swifter transmission in lending rates, which were a tad rigid in the past. In fact, rates across instruments have been easing.
- Implementation of Seventh Pay Commission recommendations by states will support purchasing power. Although the Seventh Pay Commission lacks the muscle of sixth, its implementation this year will provide mild support to growth.
- Some bounce back in pent-up demand, which was postponed due to the demonetization

Monetary Policy	Industrial Production	Inflation
Liquidity stays surplus, allows transmission; MPC remains cautious on inflation	IIP returns to positive territory on account of low base	Fruit & veggies and fuel lift inflation higher

MONETARY POLICY

- The Monetary Policy Committee (MPC) of the Reserve Bank of India (RBI), during its review of the monetary policy on August 2, 2017, announced a 25 bps reduction in the repo rate to 6%, reverse repo rate to 5.75%, and marginal standing facility rate to 6.25%
- The MPC maintained its neutral monetary policy stance, but is now more comfortable with the inflation trajectory since several upside risks have reduced or not materialized
- Liquidity was surplus on the back of high deposit growth, front-loading of government spending, and frenetic dollar purchases by the RBI
- Liquidity glut has lowered lending rates across instruments
- Credit growth was 6.5% on-year, mildly up from 6.3% in the previous month, showing some sign of recovery from the after-effects of demonetization
- Deposit growth continued to be strong at 9.6% as of September 1, 2017, though it is lower than the peak of 15.3% in December 2016

INDUSTRIAL PRODUCTION

- The Index of Industrial Production (IIP) grew 1.2% in July, up from -0.17% in June, the month when GST related uncertainties had led to destocking and cutback in production
- The turnaround was largely on account of low base of last year.
- IIP growth in July 2016 stood at 4.5%, a sharp slowdown from 8% in June 2016. July's IIP index is lower than June's, suggesting slowdown on a sequential basis
- Among the sectors, electricity did the best, growing at 6.5% (up from 2.2% in June), followed by mining, which grew 4.8% (up from 0.4%). Manufacturing activity, which at 77.6%, has the largest weight in IIP, was almost stagnant. Manufacturing IIP grew a meagre 0.08% in July compared with -0.5% in June
- According to the use-based classification, while capital goods continued with their downward journey (growing 1.02% in July), intermediate goods closely followed suit and grew negatively (-1.8%) for the second consecutive month

INFLATION

- Consumer price index (CPI)-based inflation rose 100 bps to 3.4% in August from 2.4% in July, marking the second month of ascent
- Food inflation turned positive, while implementation of GST rates (which are higher than the erstwhile service tax) pushed up services sector inflation
- Food inflation climbed as the low-base effect waned, and on the back of sharp increase in food and vegetables inflation
- Fuel inflation jumped higher in July, led by a steep increase in diesel and petrol prices – which rose to the highest level since August 2014
- Core inflation pressures rose at the consumer price level, on account of GST-led price increases, but stayed muted at the wholesale price level reflecting low pricing power of manufacturers
- CRISIL expects CPI inflation to average 4% in fiscal 2018, down from 4.5% in fiscal 2017. In line with this forecast, we do not expect another rate cut by the RBI

CRISIL
An S&P Global Company

Interest Rate	Rupee	Trade
Yields claw up with inflation	Rupee scales a two-year high	Exports revive but trail growth in imports

INTEREST RATE

- Yield on the 10-year government security (G-sec) ended August at 6.53%, up 6 bps on-month
- Warning signals on inflation by the MPC and some pick-up in inflation put upward pressure on yields
- Corporate bond yields rose in tandem, with yields on the 10-year paper moving up 8 bps on-month to 7.22% by August-end
- This year, comfortable liquidity, benign inflation outlook, and lower net borrowings by the central government should more than compensate for the slight upside pressure on yields owing to higher state development loan issuances because of Ujwal Discom Assurance Yojana
- CRISIL expects the 10-year G-sec yield to settle ~6.7% by March 2018

RUPEE

- The rupee's robust run continued in August, with the currency crossing the 64-mark for the first time in two years
- Rupee averaged 64 per US dollar in August, 0.8% stronger on-month
- Boosted by foreign portfolio investments and a weaker dollar, the rupee has been among the top-performing emerging market currencies
- The gain comes amid weaker industrial growth, raising concerns regarding the economic impact
- CRISIL expects the rupee to settle at 65.5 per dollar average in March 2018, compared with 65.9 in March 2017

TRADE

- For the first time since the fiscal began, sluggish merchandise exports growth perked up to 10.3% on-year in August. However, it still trailed far behind imports growth, which strengthened to 21% on-year from 15.4%. Consequently, trade deficit rose by $3.9 billion on-year to $11.6 billion
- The August recovery in exports was driven by petroleum products, whose export growth shot up to 36.6% on-year in August from 20.3% in the previous month, owing to higher oil prices. Price of Brent crude averaged $51.7 per barrel; 6.7% stronger on-month and 12.8% stronger on-year
- While higher oil prices also pumped up oil imports by 14.2% on-year, non-oil imports growth raced past at 23.1%. The latter reflects healthy domestic consumption demand in the economy
- Normal monsoon, low inflation, implementation of Seventh Pay Commission, and release of pent-up demand post-demonetization, are all expected to yank up domestic consumption, going forward
- While exports are likely to recover this year owing to higher global growth, it could face challenges from a strengthening rupee and falling intensity of international trade
- Due to a wider trade deficit, we expect current account deficit to increase to 1.5% of GDP in fiscal 2018 from 0.7% of GDP in fiscal 2017

Source: CRISIL Research

About CRISIL Limited

CRISIL is an agile and innovative, global analytics company driven by its mission of making markets function better. We are India's foremost provider of ratings, data, research, analytics and solutions. A strong track record of growth, culture of innovation and global footprint sets us apart. We have delivered independent opinions, actionable insights, and efficient solutions to over 100,000 customers.

We are majority owned by S&P Global Inc., a leading provider of transparent and independent ratings, benchmarks, analytics and data to the capital and commodity markets worldwide.

About CRISIL Global Research & Analytics (GR&A)

CRISIL Global Research & Analytics (GR&A) is the world's largest and top-ranked provider of high-end research, risk and analytics services. We are the world's largest provider of equity and fixed-income research support to banks and buy-side firms. We are also the foremost provider of end-to-end risk and analytics services that include quantitative support, front and middle office support, and regulatory and business process change management support to trading, risk management, regulatory and CFO functions at world's leading financial institutions. We also provide extensive support to banks in financial crime and compliance analytics. We are leaders in research support, and risk and analytics support, providing it to more than 75 global banks, 50 buy-side firms covering hedge funds, private equity, and asset management firms. Our research support enables coverage of over 3,300 stocks and 3,400 corporates and financial institutions globally. We support more than 15 bank holding companies in their regulatory requirements and submissions. We operate from 7 research centers in Argentina, China, India, and Poland, and across several time zones and languages.

CRISIL Privacy Notice

CRISIL respects your privacy. We use your contact information, such as your name, address, and email id, to fulfil your request and service your account and to provide you with additional information from CRISIL and other parts of S&P Global Inc. and its subsidiaries (collectively, the "Company") you may find of interest.
For further information, or to let us know your preferences with respect to receiving marketing materials, please visit http://www.crisil.com/privacy. You can view the Company's Customer Privacy at https://www.spglobal.com/privacy.

Last updated: April 2016

Disclaimer

CRISIL has taken due care and caution in preparing this report. Information has been obtained by CRISIL from sources which it considers reliable. However, CRISIL does not guarantee the accuracy, adequacy or completeness of any information, and is not responsible for any errors in transmission; and especially states that it has no financial liability whatsoever to the subscribers / users/ transmitters/ distributors of this report.

Argentina | China | Hong Kong | **India** | Poland | Singapore | UK | USA

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

in /company/crisil @CRISILLimited f /CRISILLimited /user/CRISILLimited

CRISIL
A S&P Global Company