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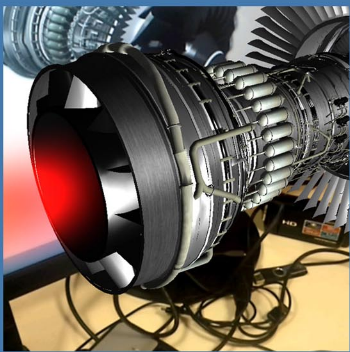
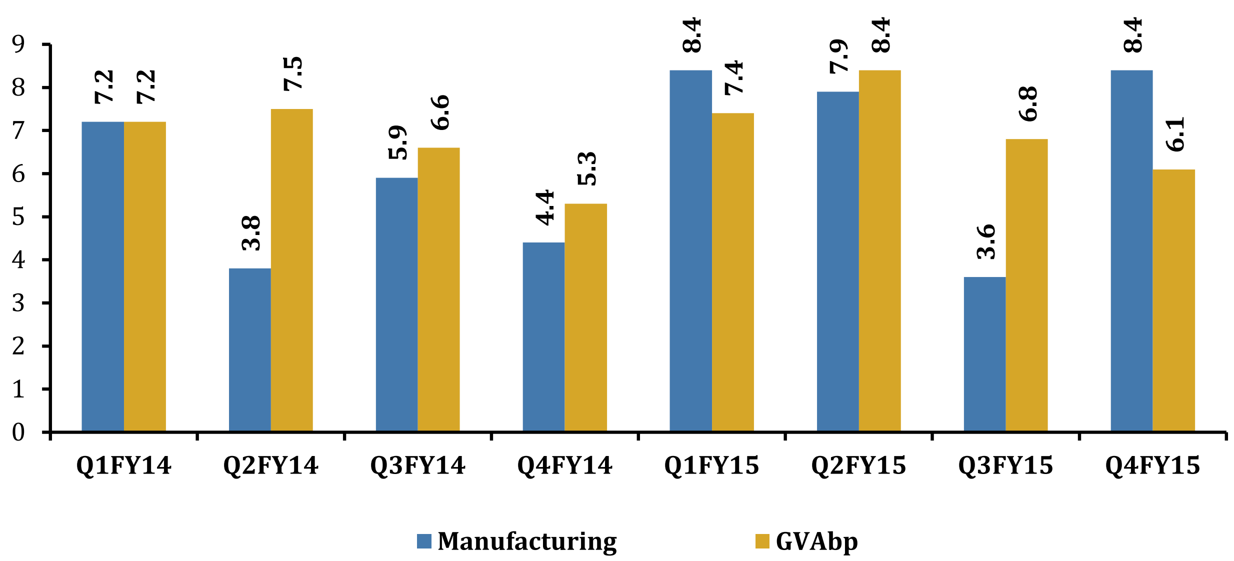


May 2015

Economy seems to be on higher growth trajectory amid a dubious outlook

India's GDP growth surged to 7.3% during the last completed fiscal as against 6.9% in the previous one driven mainly by services and partly manufacturing. GDP in the fourth quarter of 2014-15 (Jan – Mar 2015) also accelerated to 7.5% from a revised 6.6% a quarter ago. This time, India surpassed China in terms of economic growth to become the highest growing among large economies.

Fig1: Indian GVA and Manufacturing Growth



The new method of national income accounting showed that GVA at basic prices achieved 7.2% growth during fiscal 2014-15 as compared to 6.6% in the previous fiscal supported by industry and services. Services grew by double digit (10.2% vs. 9.1% last fiscal), industry recovered well (6.1% vs. 4.5%) owing to higher growth in all sub-sectors other than mining but virtually stagnant firm sector was the spoilsport (0.2% growth vs. 3.7%).

However, the quarterly figure witnessed a slowdown in GVA during the second half of 2014-15 as growth dropped to below 7% in both the third and fourth quarter. Fourth quarter conceded lowest GVA growth in fiscal 2014-15 at 6.1% due to dismal firm sector and poor public spending. Only industry bounced back led by recovery in manufacturing.

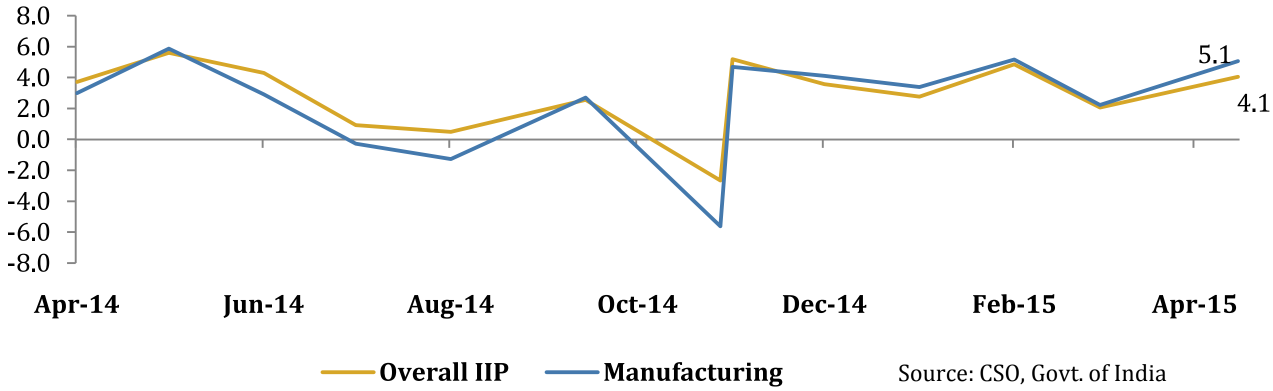
Outlook of economic growth: We expect industrial production to deliver better numbers in the next quarters while service sector is expected to keep its pace as govt. expenditure will be back on track in the ongoing quarters. Agriculture is a major concern as lower-than-average rainfall in some parts of India may weigh on firm production. Export at present is considered as another bottleneck to faster growth on the back of weak recovery in Europe and a sudden drop in growth in the US.

Industrial Production

IIP reflecting recovery in industrial activity

Industrial activity picked up in April, posting a better-than-expected 4.1% expansion, up from 2.8% in the previous month and lending view that a revival may be underway. The manufacturing output is 5.1% higher compared to the same month a year ago. However, Electricity recorded 0.5% decline and mining conceded a slower 0.6% growth over Apr 2014.

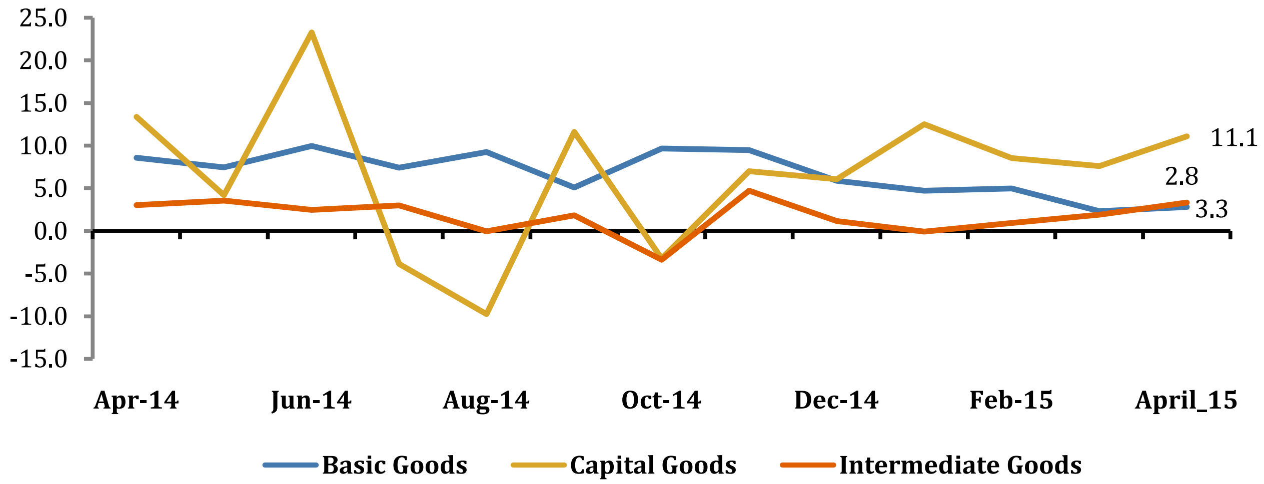
Fig2: Industrial Output Growth from Apr 2014 to April 2015



Source: CSO, Govt. of India

Use-based classification – The index of industrial production (IIP) rose to a two-month high on the back of 11.1% expansion in capital goods, 3.3% growth in intermediate goods and 2.8% growth in basic goods during April 2015 vis-à-vis April 2014 for the new fiscal 2015-16. The most impressive fact of Apr data is the comeback of consumer goods sector. Consumer durables and Consumer non-durables during April 2015 have recorded 1.3% and 4.4% growth respectively with the overall growth in Consumer goods being 3.1%.

Fig3: Growth in sub-sectors of manufacturing

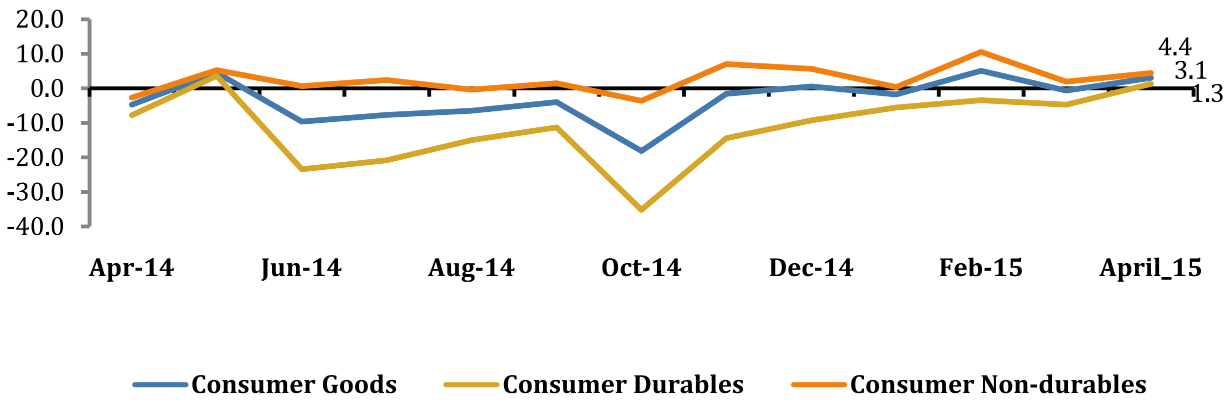


Source: CSO, Govt. of India

Industry group-wise analysis of engineering products during April 2015

Among the ten industry groups (as per the 2-digit NIC -2004) of manufacturing sector that came under engineering segment, three witnessed negative growth during April 2015. 'Machinery and Equipment' led the pack with the highest growth of 20.6% during April 2015 followed by Electrical machinery and apparatus with 13.4% growth. Contrastingly 'Office, accounting and computing machinery' remained the worst performer with 36.5% decline in production during April 2015 followed by 'Radio, TV and communication apparatus' conceding a decline of 34%.

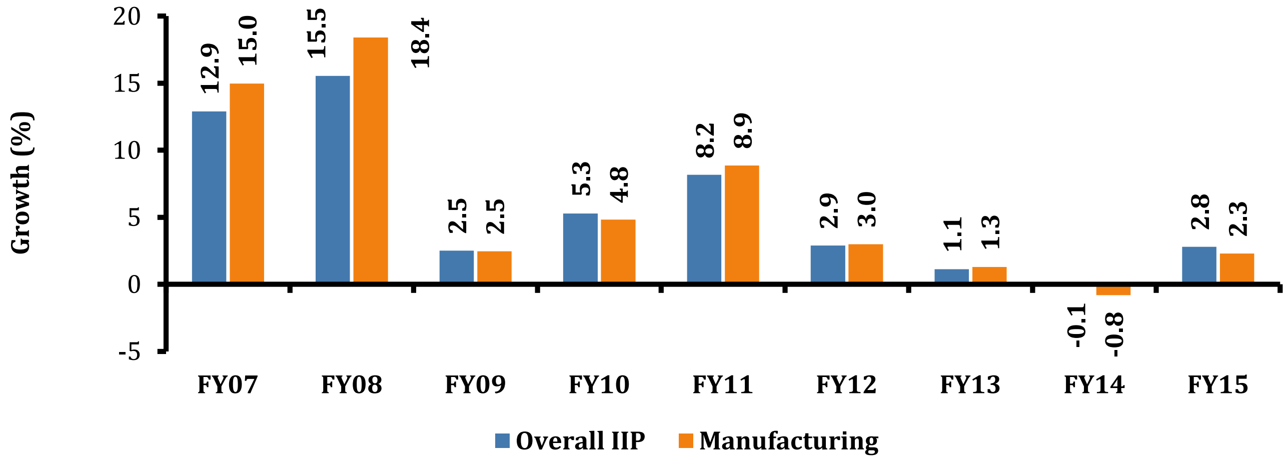
Fig4: Growth in Consumer Goods



Source: CSO, Govt. of India

FY15 figures indicated industrial recovery – Industrial production grew by 2.8% in FY15 as against 0.1% contraction in the previous fiscal. Mining, Manufacturing and Electricity witnessed 1.4%, 2.3% and 8.4% growth respectively. Within manufacturing, capital goods and basic goods bounced back in FY15 with a decent 6.2% and 6.9% respectively from a decline of (-) 3.6% and 2.1% during the same period last fiscal. However, consumer goods depicted a gloomy picture.

Fig5: IIP Growth in Different Fiscal Year



Source: CSO, Govt. of India

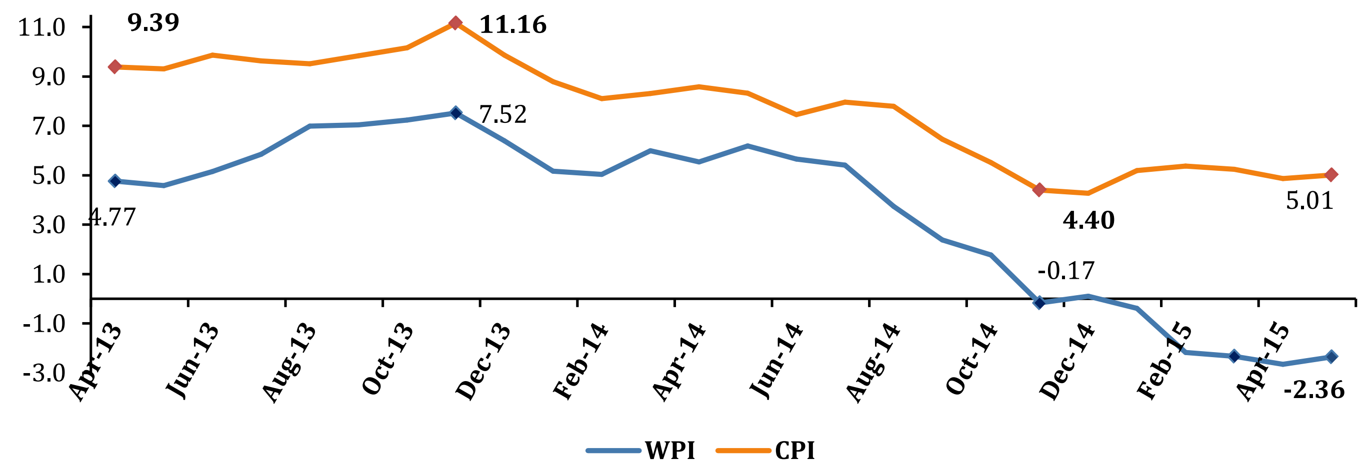
Outlook for industrial production: Industrial growth on the rise – Manufacturing sector continue to show impressive performance with signals of further improvement driven by a slew of reform measures by the govt. and initiatives like 'Make in India'. Easing of inflation on the other hand also provided RBI the necessary elbow room to reduce the policy rate three times in 2015 that may aid the industrial recovery following the monetary transmission of the same by commercial banks that may in turn provide a fillip to industrial growth. We expect industrial production to do better in the ongoing fiscal.

Inflation

Retail inflation edged up to 5.01%, while Wholesale prices dropped by 2.4% in May 2015

Retail inflation or Inflation based on Consumer Price Index (CPI) rose to 5% year-on-year in May 2015 from 4.9% a month ago due to uptick in prices of fuels over the course of the month. Urban CPI remained contained in May 2015, at par with April 2015 (4.4%). However the rural CPI increased to 5.5% in May 2015 from 5.3% in April 2015. Rural CPI exceeded urban CPI in May 2015, for the fifth month in a row and the wedge between the two widened further. The Consumer Food Price Index (CFPI) for May 2015 dropped at 4.8 % as against 5.1% in the previous month of April 2015. Core-CPI inflation (which excludes food & beverages and fuel & light) firmed up to 4.6% in May 2015 from 4.3% in the previous month. The headline CPI exceeded core-CPI for the fifth month in a row. The Wholesale Price Index based inflation continued to be negative for the sixth straight month and recorded at (-) 2.4% in May 2015 as against (-)2.7% in April 2015.

Fig6: WPI and CPI Inflation from April 2013



Source: CSO, Office of the Economic Advisor, Govt. of India

Inflation Outlook: inflation to rise marginally by the end of 2015 – The pick-up in transport and communication is the main reason behind the pick-up in core inflation. The fear of monsoon to exert pressure on price remains. But it is strongly believed by many market experts that even if there arises any upside pressure on inflation, it will dissipate over the year on account of slackening demand. Despite adverse weather conditions, food prices have not flared up. It is expected that if CPI and food inflation continues to behave on similar lines, then RBI expects inflation to rise to 6% by January 2016.

Non-food credit disbursal continued to show poor growth in Apr 2015 - Non-food bank credit growth decelerated to 8.9% in Apr 2015 from 14.2% in the same month last year. Credit growth to industry nearly halved to 6.4% during Apr 2015 from 12.3% in Apr 2014. Deceleration in credit growth to industry was observed in virtually all major sub-sectors. Credit disbursal towards manufacturing sector during Apr 2015 was recorded a lower 10% growth during the first month of FY15 as against 21.1% during the same month last year.

Declining trend of rupee continued amid possibility of rate tightening in the US

Indian Rupee weakened for the third consecutive month in May 2015 (as per RBI data) due to substantial outflow of dollar as Foreign Portfolio Investors pulled out funds from their equity and debt investments. Concern on strengthening of dollar in the international market due to the possibility of interest rate tightening by the US Federal Reserve also acted against the rupee as rate tightening could happen anytime. However, The Indian currency appreciated against other major traded currencies like Euro, Yen and British pound.

Table1: Performance of Indian Rupee vs. Major Traded Currencies

	USD	GBP	EURO	YEN
Change (%) in May 2015	0.29%	-0.19%	-0.89%	-3.83%
Direction	Depreciation	Appreciation	Appreciation	Appreciation
Change (%) in 2015	0.68%	-0.80%	-9.22%	-2.74%
Direction	Depreciation	Appreciation	Appreciation	Appreciation

Source: RBI Reference Rates

Outlook for rupee – We still apprehend that the weakening trend of rupee will continue as volatility in the indian capital market and possibility of tighter interest rate regime in the US may continue to put pressure on rupee. However, recovery of rupee cann't also be ruled out depending on the stance of RBI to intervene in the currency market, trend of commodity price (specially crude price) in the international market and decision of the US Fereral Reserve to defer rate tightening following the recent downturn in the US. Rupee may likely to move within a broader range of 62 – 64 per dollar in the short term.

Sharp fall in Current Account Deficit (CAD) brought relief for the policymakers – India's CAD improved significantly to 0.2% of GDP (US$ 1.3 billion) during the fourth quarter of fiscal 2014-15 from 1.6% of GDP (US$ 8.3 billion) in the previous quarter primarily on account of lower trade deficit as net earnings through services and primary income (profit, dividend and interest) witnessed a decline over the previous quarter though secondary income recorded a marginal increase of 0.4 per cent. However, on a year-on-year basis, the CAD was a tad higher than US$ 1.2 billion (0.2% of GDP) recorded in the fourth quarter of 2013-14.

RBI reduced the policy repo rate by 25 basis points (bps) in its 2nd bi-monthly policy meet 2015-16 on 3rd June 2015 – RBI reduced the policy repo rate by 25 bps to 7.25% in the said policy meet. Consequently, reverse repo rate, bank rate and MSF rate also stood unaltered at 6.25%, 8.25% and 8.25% respectively. CRR however was kept unchnaged at its several decade low of 4%. This is the third time RBI opted for monetary easing following the downward trend of inflation.

Policy stance – RBI said that some risks to inflation still remain as below normal rainfall has been predicted this season that might put pressure on agricultural prices. Further, the apex bank urged that govt. support is also required to step up investments other than cheaper borrowing. They expected, rather asked the banks to pass on the effect of three policy rate cuts to the end users.

Likely outcome of RBI rate cut – Policy rate has been reduced by 75 bps in three phases during 2015. This rate cut is strongly expected to be followed by the commercial bank and lower the borrowing rate as their lending rate from RBI has now become cheaper by 0.75%. Lower borrowing rate will encourage businesses and in turn help to accelerate economic activities.

GLOBAL SCENARIO

US Economy actually contracted in the first quarter of 2015 – The second estimate showed that real GDP in the US actually conceded 0.7% decline quarter-on-quarter during the first quarter (Q1) of 2015 as against a 2.2% growth in the fourth quarter of 2014. The advance estimate for Q1 observed a feeble 0.2% growth that was revised downward in the second estimate. The decrease in real GDP in the first quarter primarily reflected dismal trade performance, weak nonresidential fixed investment, and lower state and local government spending. Wintry weather in some parts of the country, a strong dollar and a slowdown in shipping due to labour dispute in West Coast ports also believed to have played a role by causing slowdown in production. The underlying trend of broader economy also remained weak as industrial production for the country fell for the fifth straight month in April while consumer confidence dropped to a seven-month low in early May 2015. This was third pullback of the US economy after Q1 in 2011 and 2014 since the current recovery began in mid-2009.

The US Federal Reserve did not raise interest rate in June – The central bank of the US kept their benchmark interest rate unchanged in the range of 0% - 0.25% in its least policy meet on 17th June. As per the Fed, the persisting uncertainty in the economy did not demand any rate hike at present. Rather, holding of rate would support maximum employment and price stability. Non-farm payroll in the US rose by 280,000 in May 2015 while the unemployment rate was essentially unchanged at 5.5 percent.

Source: RBI, Govt. of India Websites, ICRA, Newspapers & Periodicals