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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 focus on three key macroeconomic parameters – growth, inflation and fiscal situation – to gauge state-level developments and highlight the gaps in state-level performance.

State of states

Macro-economic developments at the national level and central government actions usually take the center stage. But these days, a lot of action is taking place at the state level as states are getting exposed to competition and now have the responsibility for some key reforms such as land and labor. The average gross domestic product (GDP) growth rate for states ranged from 3% per year in Goa to 10% per year in Gujarat during fiscals 2013 to 2016. Among the 12 states whose data was available for fiscal 2017, 7 have grown faster than the national average, with Madhya Pradesh, Andhra Pradesh and Bihar leading the pack.

Poorer states have to grow faster to catch up. Among poorer states, Bihar and Rajasthan lost the tag of fast growing between fiscals 2013 and 2016. The sectoral pattern of growth in states has implications for job creation. After agriculture, construction and manufacturing are the two key labor-intensive sectors. Gujarat is the top performer in construction and manufacturing growth, and among poorer states, Bihar and Chhattisgarh have witnessed faster manufacturing growth. These states, therefore, are likely to have been more successful than others in job creation. The share of manufacturing in GDP has gone up in Chhattisgarh, Gujarat, Goa and Bihar. Its share in Gujarat's GDP (at 34.4% in fiscal 2016) is approaching that of China. Maharashtra, another highly industrialized state, is lagging here.

The pace of increase in prices varies across states. The good news is that it has fallen across states between fiscals 2013 and 2017. During this period, average inflation in Gujarat, Madhya Pradesh and Haryana has been below the national average of 6.8%. Interestingly, these states have the highest average GDP growth. So, no growth inflation trade-off here.

Recent worsening in fiscal situation of states has been a key worry. Chhattisgarh, Telangana, Karnataka, Maharashtra, Odisha and Gujarat stand out with low indebtedness and low deficit indicators. Tamil Nadu, Andhra Pradesh and Madhya Pradesh also have low indebtedness, but their fiscal prudence is threatened by rising deficits. Remaining states have high debt levels and worsening deficit levels. Part of the worsening fiscal health is due to issuance of Ujwal Discom Assurance Yojana bonds and farm loan waivers. If the implementation of the Goods and Services Tax (GST) leads to a notable pick-up in tax revenue, this will offset some of the transitory stress on state finances. Otherwise, states will resort to cutting their investment spend in their zeal to meet fiscal targets.

Money and Banking	Industrial Production	Inflation
Liquidity gets an October surprise	Hint of resilience in IIP	Inflation creeps higher on costlier food and fuel

MONEY AND BANKING

- System liquidity, though still in surplus, dipped significantly in October, led by higher government cash balances, increase in currency in circulation and a pick-up in bank credit growth
- The Reserve Bank of India's (RBI) net daily average absorption through its liquidity adjustment facility – repo, reverse repo, term repo, term reverse repo, marginal standing facility, and statutory liquidity ratio – reduced to Rs 1.2 lakh crore compared with Rs 2.1 lakh crore in September and the peak of Rs 4.3 lakh crore in March
- Interest rate transmission across instruments saw a brief pause with tighter liquidity conditions and some upward pressure on the 10-year government security (G-sec) yield
- Post demonetization, faster easing of bank loan rates has pushed up the demand for bank credit. Favorable rates in the commercial paper market have kept borrowing there rife, too
- The RBI's Monetary Policy Committee is expected to keep repo rate unchanged in its December review in view of rising inflationary pressures

INDUSTRIAL PRODUCTION

- Index of Industrial Production (IIP) was up 3.8% on-year in September, after growing 4.5% in August, riding on festive demand
- This was supported by 3.4% growth in manufacturing (the largest contributor to IIP with 77.6% weight) and 7.9% in mining (second-largest contributor with 14.4% weight). Electricity (having 7.9% weight) rose 3.4%, slower than the 8.3% seen in August
- Government's recent measures to address concerns related to GST, especially in the micro, small and medium enterprises segment, augur well for IIP growth
- Core sector grew at 5.2% in September, which marked the sharpest rise since April
- In terms of use-based classification, capital goods grew 7.4%, but on a very low base
- Consumer non-durables continued to march ahead, growing 10%, which suggests buoyant rural demand
- Durables, on the other hand, de-grew (-4.8%), reflecting to some extent still fragile urban demand

INFLATION

- Both consumer price index (CPI)- and wholesale price index (WPI)-based inflation rose to 3.6% in October
- CPI inflation rate was 30 basis points (bps) up on-month, whereas WPI inflation rate jumped 100 bps
- Unseasonal rains in October pushed up vegetable prices, whereas globally, energy prices soared for the fourth consecutive month, putting pressure on imported inflation
- Core inflation (measured by the CRISIL Core Inflation Indicator, or CCII, which excludes volatile food articles, metals and fuel prices), was about 20 bps higher on-month at 1.5% compared with 1.3% in September
- In the months ahead, inflation could see an upside from further rise in oil prices and higher household spending led by (i) implementation of farm loan waiver and (ii) expected upward revision in salary and allowances of state government employees

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Interest Rate	Rupee	Trade
Yields harden on inflation and fiscal concerns	Dollar's advance trips rupee	Setback to export recovery

INTEREST RATE

- Yield on the 10-year G-sec ended October at 6.86%, up 20 bps on-month
- Average yields for the month was 6.77%, up 18 bps
- The RBI, in its latest monetary policy statement on October 4, 2017, raised its inflation projection to 4.2-4.6% (up from 4-4.5% previously) for the second half of the current fiscal, because of firming global oil prices and uncertainty about the kharif farm output
- Rising oil prices fuelled concerns about inflation further, diminishing the rate-cut hopes in the near future and pushing up yields
- In light of these recent developments, CRISIL expects the 10-year G-sec yield to settle around 6.9% by March 2018

RUPEE

- The rupee averaged 65.1 per dollar in October, 1% weaker on-month, but 2.5% stronger on-year
- While the appreciating dollar also dragged down currencies of other emerging markets and advanced economies, the rupee fared better than its peers
- The currency gained some traction from foreign portfolio investors, whose investments rebounded to $2.9 billion net inflows as against $1.5 billion net outflows in September, primarily driven by debt market investments
- The rupee performed better than other emerging market currencies, its depreciation capped by foreign inflows
- After falling for 10 successive months, the dollar index, measuring the dollar’s value against the currencies of its major trading partners, rose an average 1.8% on-month in October
- Though foreign inflows made a comeback, the dollar's strong appreciation weakened the rupee

TRADE

- India’s merchandise exports declined 1.1% on-year in October, compared with 25.7% growth in September
- Trade deficit increased to $14 billion from $11.1 billion in October 2016
- On a seasonally adjusted basis, exports declined 15.6% on-month and imports 2.3%. This is the first time that exports have declined since July 2016, driven by non-oil goods
- Import growth has moderated in the recent months due to a decline in gold imports for the second consecutive month
- For fiscal 2018 so far, import growth has averaged 23.8% on-year, compared with 9.4% export growth. Import growth is likely to remain higher than export growth in the rest of the fiscal due to higher oil prices relative to last year, and healthy consumption demand
- While higher global GDP and trade growth this year will be conducive to export growth, challenges in adjusting to the new GST regime can pose downside risks
- CRISIL maintains current account deficit outlook at 1.5% of GDP in fiscal 2018 from 0.7% of GDP in fiscal 2017

Source: CRISIL Research

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