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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 look at the challenges that India faces in boosting the share of manufacturing in GDP.

Swimming against the tide

India has woken up to the idea of developing its manufacturing sector as an engine of growth and a means of creating employment for its fast expanding workforce, albeit late in the day.

In the past two decades, the share of manufacturing in GDP has stagnated at 15-17%. What's more, the space vacated by China in labour-intensive segments such as garments, textiles and footwear is being filled up by counties such as Vietnam and Bangladesh rather than by India.

The Narendra Modi-led National Democratic Alliance has stepped up attempts to boost the sector via its flagship programme 'Make in India'. But to make a meal of this, India will have to overcome both internal and external challenges.

It is hard for Indian manufacturing firms to be competitive, given domestic constraints such as inadequate physical infrastructure (reliable power, water), inflexible labour laws and an opaque land acquisition system. And once the goods are produced, they are faced with other inefficiencies in the system, such as logistical bottlenecks.

External constraints are becoming more binding in the new milieu. The post-global financial crisis world is witnessing a sharp slowdown in trade and a tilt towards protectionism. Trade had grown faster than GDP before the crisis, but there has been a reversal of this trend since then, leading to a decline in trade intensity of growth.

Moreover, not every advanced country has benefited from free trade. This is now breeding discontent in the segments that have been left out, leading to a backlash against trade. Using exports to prop up manufacturing growth is, therefore, unlikely to be as easy for India as it was for East Asian economies.

Another worry is the manufacturing sector's eroding ability to absorb labour in the past few years. This has adverse implications for job creation in a country where over 12 million youth enter the job market each year.

Monetary Policy	Industrial Production	Inflation
A slice on debut	IIP: Slowdown across the board	CPI inflation falls in Sept

MONETARY POLICY

- In the first policy meeting of the monetary policy committee (MPC) chaired by the new Reserve Bank of India (RBI) governor Urjit Patel, the repo rate was reduced by 25 bps to 6.25%. As a result, the reverse repo adjusted to 5.75% and the marginal standing facility rate to 6.75% for maintaining a 100-bps band around the policy rate. The decision to cut rates was unanimous with all the six members of the MPC voting in favour.
- The MPC highlighted that the recent drop in inflation reflects a downward shift in food inflation momentum and opens up space for policy action. That said, it emphasised that the implementation of the Seventh Pay Commission recommendations, and increase in minimum wages could pose a challenge going ahead.

INDUSTRIAL PRODUCTION

- Index of Industrial Production (IIP) declined by 0.7% on-month in August, the second consecutive monthly of decline, led by a sharp fall in mining activity, along with decline in manufacturing. Within manufacturing, there was a bit of change in the trend in August. Investment-oriented sectors, which have been in red and grew negatively in the previous two months straight, saw a mild positive growth (0.1%) in August on the back of a healthy growth in basic metals (12.4%) and chemical and chemical products (5%). But consumer-oriented sectors registered a decline of 0.9%, after growing positively in the previous three months.
- According to use-based classification, the drag came from capital goods category, which saw a sharp decline of -22.2% in August, the 10th straight month of negative growth.

INFLATION

- Inflation dropped sharply to 4.3%, a one-year low, in September from 5% in August, driven by a sharp drop in food inflation to 3.9% (drop of 200 bps). Further, the monthly momentum in food inflation also slowed, indicating a decline in prices in September, particularly in food items such as vegetables. We think the positive impact of a favourable monsoon this year is starting to reflect in lower food prices.
- We expect inflation to trend lower and average 4.8% in the second half of fiscal 2017, because of the good monsoon, coupled with steps taken by the government to manage food supply. A good monsoon will also push up rural incomes and boost private consumption by 90 bps this fiscal, supporting GDP growth. Overall, we expect inflation to average 5% in fiscal 2017.

Interest Rate	Rupee	Trade
Bonds yield to liquidity	Rupee running strong	Exports trend up, but imports just won't

INTEREST RATE

- Continuing domestic liquidity and expectations of a rate cut by the RBI sent yields tumbling for the third consecutive month in September. The 10-year 7.59% G-sec ended lower by 15 basis points (bps) on-month at 6.96%. The benchmark G-sec had last fallen below 7% in July 2009. While yields slid 9 bps to 7.04% on average, the one-year fell more – 15 bps – to wind up at 6.64%.

- Liquidity has continued to expand with the central bank aiming for near-neutral levels. Liquidity was in excess for the third consecutive month in September. Net average daily absorption through the central bank's liquidity adjustment facility – or the sum of net repo, net term repo, and marginal standing facility – was up Rs 82 billion on-month to Rs 402 billion.

RUPEE

- The rupee climbed 0.3% to average 66.7 per dollar in September. Robust domestic macros and global cues drew foreign capital, bolstering the rupee for the third straight month. The currency ascended 0.3% on-month on average and ended September at 66.7 per dollar, stronger by 0.5%. While a rising dollar capped further gains for the rupee, the Russian rouble, Indonesian rupiah, and the South Korean won strengthened among peers.

- Foreign investors pumped in $6.9 billion net in the second quarter, attracted by the strong fundamentals of the Indian economy amid continuing global uncertainty. In comparison, foreign portfolio investment in the previous quarter was a mere $1.6 billion while net foreign portfolio investment trebled on-month to $3 billion. Net foreign portfolio investment for the fiscal up to September was $8.5 billion compared with net outflows of $2.7 billion in the corresponding period of the previous fiscal.

TRADE

- India's merchandise exports looked up in September, rising 4.6% on-year. Though this came on a low base (exports had tanked 24.3% in September last year), a gradual recovery is possibly underway. Weakness in global demand has kept exports sluggish. Slow global growth could impact India's exports further.

- But a bigger worry is the slack in imports, where there is no decisive sign yet of a pick-up. Also, trade in services has turned more worrisome. Services exports fell 1.5% on-year in August – the second consecutive month of decline – while imports rose 3.6%. For April-August, the services surplus balance was nearly $1.3 billion lower on-year, at $26.9 billion. Together, goods and services exports declined 1%, while imports were 12.1% lower on-year. Overall, trade deficit, therefore, fell $23.2 billion on-year, to $6.9 billion.

Source: CRISIL Research

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