STATE BANK OF INDIA

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ECOWRAP

Incipient recovery on the anvil?

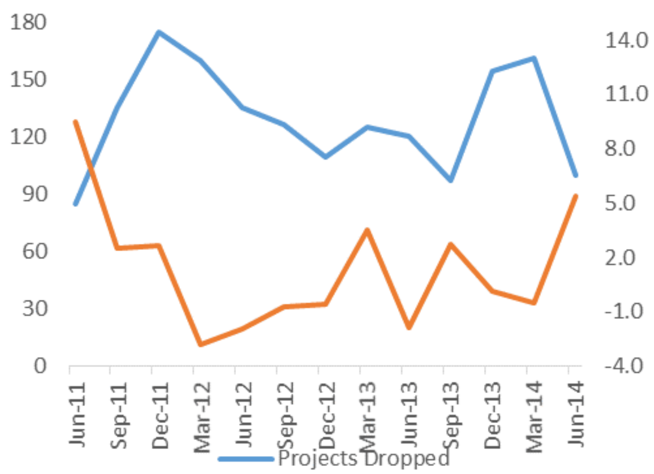
Our internal prognosis suggests that an incipient recovery is round the corner. Our CPI glide path shows that retail CPI will be below 5.5% in November. The expected trajectory in CPI will be benign and breach 7% in August, 6.5% in September and 6% in October. Inflation in November may be pulled down by 20% purely because of the base impact. However the good thing is that one should not dig too much into declining trend attributable to base impact. Our trend analysis suggests that on an average only 8%-9% is attributable to base impact, and the rest to incremental momentum. Even though retail CPI numbers will accelerate after November, the average CPI for FY15 will be no more than 7.5%. Thus, there is no denying of the fact that the incremental impact has slowed down significantly in the last couple of months. Meanwhile, IIP growth in June is likely to cross 5%, with visible recovery in passenger car sales, and significant slowing down of the de-growth in commercial vehicles segment. There is also an improved sentiment on the consumer spending. With monsoon rains fast recovering, our first quarter GDP growth estimates is now trending at close to the median estimate for FY15 at 5.5%. On the external sector, India's export growth has an asymmetric relationship with global exports (when global exports pick-up, Indian exports clearly outstrip on the upside, but when global exports decline, Indian exports also outstrips on the downside), and this well help our exports grow faster in the emerging environment.

Our internal prognosis suggests that an incipient recovery is round the corner. Various macro-economic indicators ranging from inflation to external sector are showing positive signs.

Inflation, IIP & Export Growth

Our CPI glide path shows that retail CPI will be below 5.5% in November. The expected trajectory in CPI will be benign and breach 7% in August, 6.5% in September, 6% in October. Inflation in November may be pulled down by 20% because of the base impact. However the good thing is that one should not dig too much into the declining trend attributable to base impact.

Graph 1: Number of Projects Dropped vs. IIP Growth (YoY %)



Source: SBI Research

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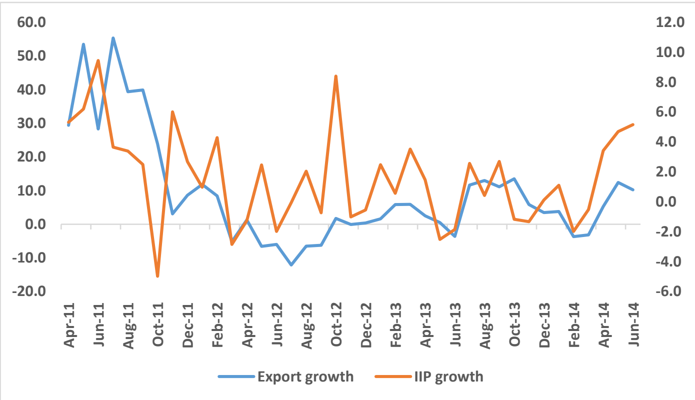
Meanwhile, during Jul'14 monsoon rains have improved significantly and as on 20 Jul'14, monsoon rains are 31% below normal compared to 45% below normal at the end of Jun'14 month. The revival of monsoon rains in the grain bowl of Northwest and Central regions of India will help speed up sowing of main summer crops such as rice, corn, soybean and cotton.

Given the strong growth in exports, we are confident that the IIP growth in Jun'14 will touch at least 5%, with visible recovery in passenger car sales, and significant slowing down of the de-growth in commercial vehicles segment. There is also an improved sentiment on the consumer spending. With monsoon rains fast recovering, our first quarter GDP growth estimates is now trending at close to the median estimate for FY15 at 5.5%. We believe, that if the CPI glide path is even milder than our expected trajectory, RBI may reconsider a softening signal towards the last quarter of FY15.

Graph 2: IIP Growth vs Export Growth (YoY)



Source: SBI Research

Table 1: Inflation Trajectory and RBI Monetary Policy

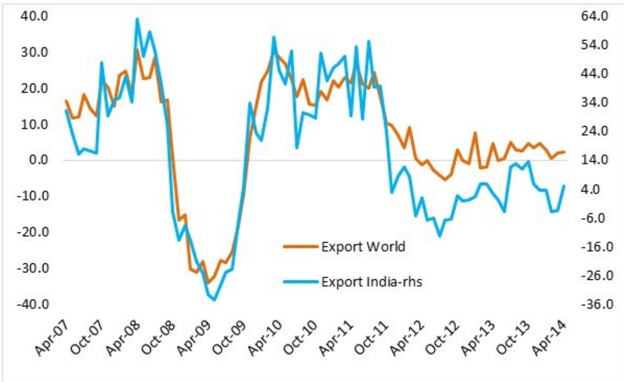
RBI Policy Dates	Available CPI data at that time	Likely Action
Aug 05, 2014	Jun'14 (7.31%)	No Action
Oct 14, 2014*	Aug'14 (6.6%-6.8%) ^	No Action
Dec 09, 2014*	Oct'14 (5.8%-6.0%) ^	Rate Cut?
Feb 10, 2015*	Dec'14 (5.4%-5.6%) ^	Rate Cut?

Source: SBI Research; * Tentative Dates; ^ SBI Projection

External Sector

Going by the IMF WEO Apr'14 projection numbers, global economy is poised to grow by 3.6% in 2014 against 3.0% growth registered in 2013. Similarly global trade is also projected to grow by 4.3% in 2014 against 3.0% expansion in 2013. The good thing is that India's export growth has an asymmetric relationship with global exports (when global exports pick-up, Indian exports clearly outstrip on the upside, but when global exports decline, Indian exports also outstrips on the downside), and this well help our exports grow faster in the emerging environment.

Graph 3: India Export growth vs. Global Trade (%)



Source: SBI Research

Financing of CAD that was major issue in FY13, where CAD reached historical high of $88.1 billion (4.7% of GDP) and latter declined to $32.4 billion (1.7% of GDP) in FY14 . Interestingly, capital inflows into India could touch the highest level since the crisis (portfolio capital inflows in FY15 has already crossed $14 billion). This will enable the RBI to build up on reserves and a higher import cover (currently at 8.3 month of imports).

The new Government commensurate focus on infrastructure, will possibly led to a faster growth in productivity rather than consumption. This will help in a lower and stable inflation regime and better GDP numbers. GDP growth for Q1 FY15 may be around 5.5%. This in conjunction with the recent Railways initiative to transport perishable goods in AC compartments will address supply side logistics.

Table 2: Macro-Economic Indicators in Q1 FY15		
Indicators	Q1 FY15	Remarks
CPI Inflation	8.1%	Will decline sharply
Agriculture*	2.0%	Low Kharif sowing due to poor monsoon
Industry*	4.6%	Based on IIP numbers, including construction
Services*	6.5%	Based on trend growth
GDP Growth*	~ 5.5%	Even on the lower side it will be greater than 5.3%
Exports Growth	9.3%	Will increase to 12-13% in Q2 FY15
Imports Growth	-6.9%	Imports for the first time recorded a positive growth in Jun'14 after hovering in the negative territory for the last 12 consecutive months and would be in positive territory in coming months also.
CAD (% of GDP)	-1.5%	CAD will be range bound
Capital Flow ($ Billion)	FII: 10.9 FDI: 9.0*	Robust foreign capital flows
Source: SBI Research; * Projections		