INDIA

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UPDATE

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GDP growth—slow recovery is best. GDP growth of 5.7% was expected to be higher than in earlier quarters as manufacturing and electricity generation in 1QFY15 were better than in 4QFY14. However, given structural constraints, the expected investment cycle pick-up will take time. Besides, with no monetary policy accommodation expected for a long time, we do not expect FY2015 GDP growth to be any better than 5.6% (higher by 30 bps from our earlier forecast). If the policy momentum continues, FY2016 growth can pick up to ~6%.

Industry pushes up 1QFY15 GDP

1QFY15 GDP growth expectedly increased to 5.7%, with a pick-up evident in industrial production to 4.2% (-0.2% in 4QFY14). Manufacturing sector growth was 3.5% (-1.4% in 4QFY14) and electricity sector growth was 10.2% (7.2% in 4QFY14). On the services side, growth was muted at 6.8% (6.4% in 4QFY14), symptomatic of continuing poor consumption demand ("Trade, hotel, transport and communication" grew by just 2.8%). The saving grace for services was "Community, social and personal services", which grew at 9.1%.

On the expenditure side, real private consumption expenditure grew by 5.6%. GFCF grew by 7% on a real basis, sharply reversing a contraction of 0.9% in 4QFY14. However, this data needs to be viewed with some caution as it was against a very low base in 1QFY14.

Stabilization in progress—macro-economic numbers appear better

The growth trajectory in FY2015 has started on an improved note, providing the sense that the worst may actually be over. First, the external environment appears better and even as global challenges remain, the degree of risk aversion of the previous years is unlikely to repeat. This implies that exogenous shocks to the domestic economy will be limited. Besides, with improving global growth, exports growth is in positive territory (see Exhibit 1).

On the domestic front, the formation of a stable political system has led to improvement in business sentiment while the PMI has moved to the +50 zone, depicting expansion (see Exhibits 2 and 3). Automobile sales have turned the corner and tourist arrivals have improved (see Exhibits 4 and 5). Financial markets have reacted positively to the new government and this is expected to have a positive impact on the real sector.

Challenges remain—growth-inflation dynamics and natural resource availability

Even as inflation has come off significantly from its peak, the pace of likely contraction in core inflation may be limited. The fear is that with inflation being entrenched in the economy, any rise in consumption or investment demand will once again fuel inflationary pressure in the economy. In this context, it is likely that the monetary policy will remain restrictive and could hurt prospects for economic growth, in a scenario of likely fiscal contraction.

The recent judgment of the Supreme Court that allocation of coal blocks since 1993 are illegal raises the issue of sustaining the growth momentum. Such retrospective action can impact investment sentiment and will have negative implications for the electricity sector and hence manufacturing. In effect, this can derail the economic momentum seen in 1QFY15.

The road ahead likely to hard and bumpy

The Union Budget has taken salutary steps to channelize resources to the productive sectors but the positive implications of these steps can be realized only if followed up with micro-economic measures in areas such as labor laws and skills development. All this is expected to take a lot of time and hence FY2015 growth will be restricted to 5.6%, rising to just ~6% in FY2016.

QUICK NUMBERS

- 1QFY15 GDP growth 5.7%
- Industrial sector growth 4.2%; services sector growth 6.8%
- FY2015 GDP growth likely to be 5.6%, pick-up will be slow due to structural bottlenecks

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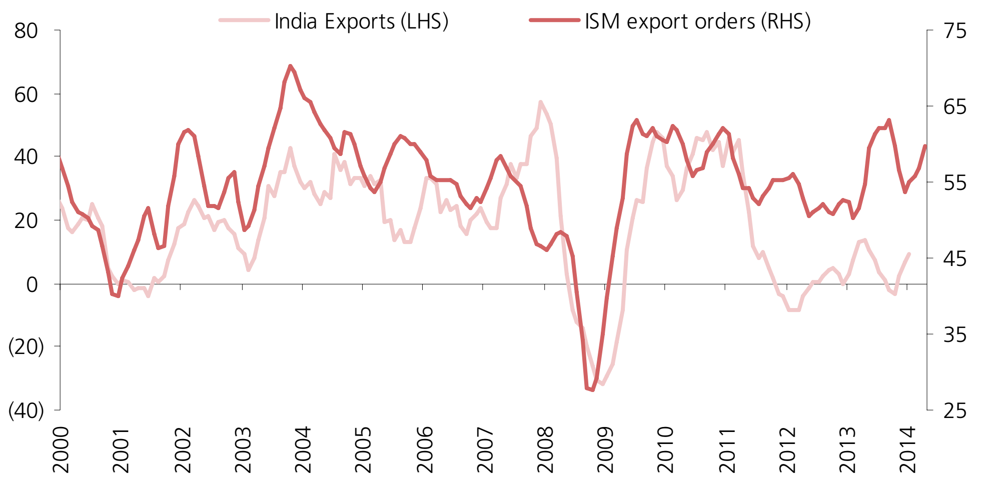
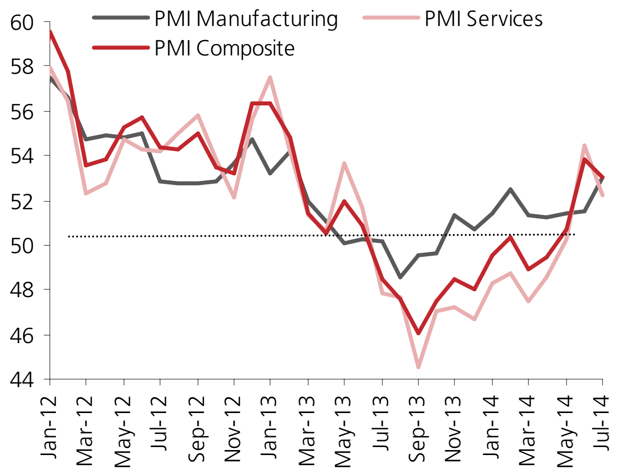
Exhibit 1: India's exports have been buoyant on improving global demand
Trends in India's exports (% yoy,3-mma, 3M lag, LHS) and US ISM export orders (index, 3-mma, RHS)



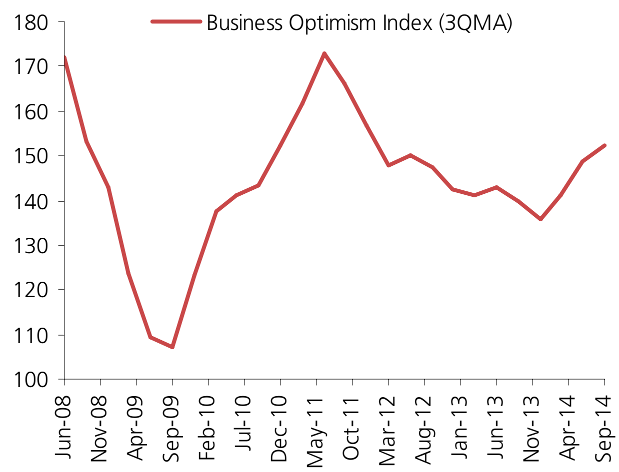
Source: CEIC, Kotak Economic Research

Exhibit 2: India's PMI has been comfortably in expansion mode, and will augur well for the industrial sector
Trends in India' PMI manufacturing, services and composite (Index,sa)



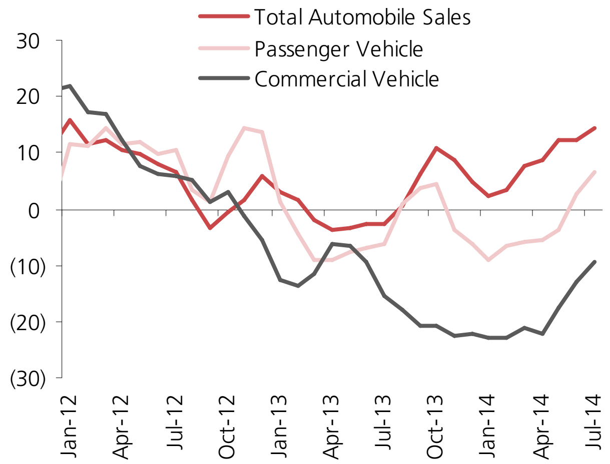
Source: Bloomberg, Kotak Economic Research

Exhibit 3: A strong political mandate has also been supportive of pick-up in business sentiment
Dun & Bradstreet Business Optimism Index (3QMA)



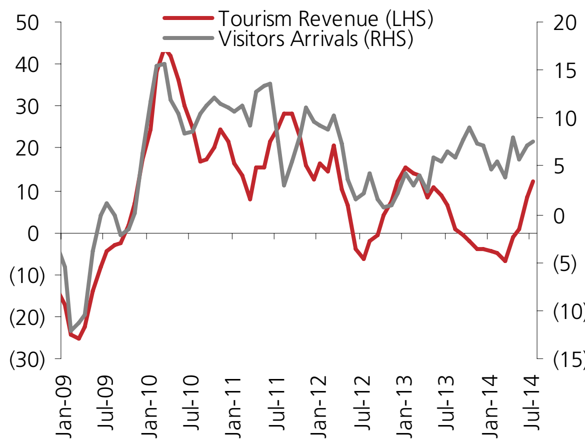
Source: CEIC, Kotak Economic Research

Exhibit 4: The auto sector is showing early signs of revival
Total automobile sales, passenger-vehicle sales and CV sales (%yoy,3mma)



Source: CEIC, Kotak Economic Research

Exhibit 5: The services sector is getting a boost from the tourism industry
Tourism revenue and foreign visitor arrivals in India (% yoy,3-mma)



Source: CEIC, Kotak Economic Research

Exhibit 6: 1QFY15 GDP grew by 5.7%, FY2015 estimated at 5.6%
Growth in real GDP at factor cost and components, March fiscal year-ends (%)

Sector	2014	1QFY14	2QFY14	3QFY14	4QFY14	1QFY15	2015E	2016E
Agriculture and allied activities	**4.7**	**4.0**	**5.0**	**3.7**	**6.3**	**3.8**	**2.3**	**2.9**
Industry	**0.4**	**(0.4)**	**2.6**	**(0.4)**	**(0.2)**	**4.2**	**3.4**	**2.9**
Mining and quarrying	(1.4)	(3.9)	0.0	(1.2)	(0.5)	2.1	1.4	0.7
Manufacturing	(0.7)	(1.2)	1.3	(1.5)	(1.4)	3.5	2.1	1.7
Electricity, gas and water supply	5.9	3.8	7.8	5.0	7.2	10.2	10.6	7.0
Construction	1.6	1.1	4.4	0.6	0.7	4.8	4.6	4.7
Services	**6.8**	**7.2**	**6.3**	**7.2**	**6.4**	**6.8**	**7.3**	**8.0**
Trade, hotels, transport, storage and communication	3.0	1.6	3.6	2.9	3.9	2.8	3.0	7.0
Financing, insurance, real estate and business services	12.9	12.9	12.1	14.1	12.4	10.4	10.8	10.5
Community, social and personal services	5.6	10.6	3.6	5.7	3.3	9.1	10.8	6.0
Real GDP at factor cost	**4.7**	**4.7**	**5.2**	**4.6**	**4.6**	**5.7**	**5.6**	**6.0**
Non-agricultural GDP	4.7	4.8	5.2	4.7	4.3	6.0	6.1	6.5

Source: CSO, CEIC, Kotak Economic Research estimates

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