INDIA GDP & MONETARY POLICY DECEMBER 2017

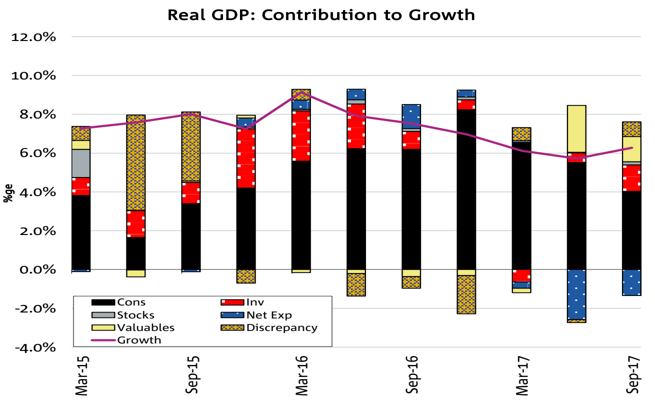
NAB Group Economics

The Indian economy accelerated in the September quarter, recording a 6.3% yoy expansion. This was the first increase in the growth rate following 5 consecutive quarters of deceleration. NAB Economics is forecasting a 6.4% GDP growth rate in 2017, followed by a 7.1% expansion in 2018. In the December meeting, the RBI held the Repo rate at 6%– as expected. NAB is forecasting the Repo rate to remain on hold at 6%.

GDP Outcome

The Indian economy has picked up pace in the September quarter, rising by 6.3% yoy, an improvement from June quarter's low of 5.7%. In fact, this is the first time there has been an improvement in the growth rate, following 5 quarters of deceleration.

GDP by expenditure

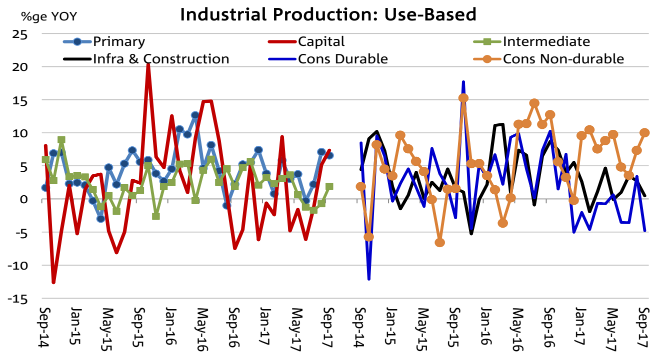


Source: NAB Economics/CEIC

In terms of components, consumption was the largest, contributing 4 ppts, lower than the 5.5ppts contribution last quarter – reflecting dwindling consumer confidence regarding employment conditions. Investment spending (1.4 ppts) also made a useful contribution, although it is too early to call this the start of a sustained improvement, particularly for private investment spending. Net exports (-1.3 ppts) was the main detractor, similar to last quarter, and reflects weaker export growth relative to imports. Elsewhere, there was a slight contribution from stocks and a somewhat sizeable statistical discrepancy (which contributed 0.8ppts).

The data on investment spending does (somewhat) line up with other partials. For example, industrial production data by use indicates a ramping up of capital spending. However, infrastructure spending and consumer durable goods spending seems to have languished, indicating only a modest pickup in overall investment spend.

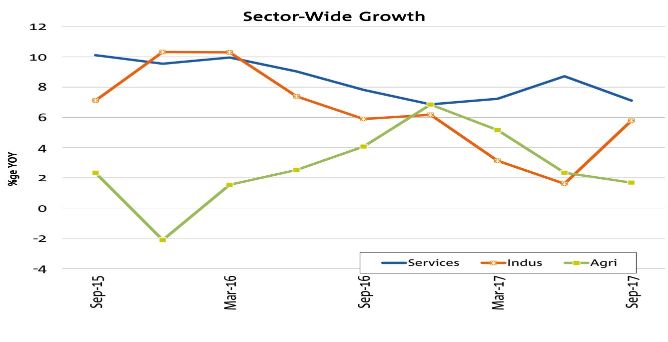
Industrial production – use based



Source: CEIC

By sector, the main development has been the strength in the industry sector (from 1.6% to 5.8%), with further softness in the agriculture sector (from 2.3% to 1.7%), reflecting uneven and slightly lower outcomes from the recent monsoon rains and unfavourable base effects. Services (from 8.7% to 7.1%) also eased, but was still the best performing sector overall.

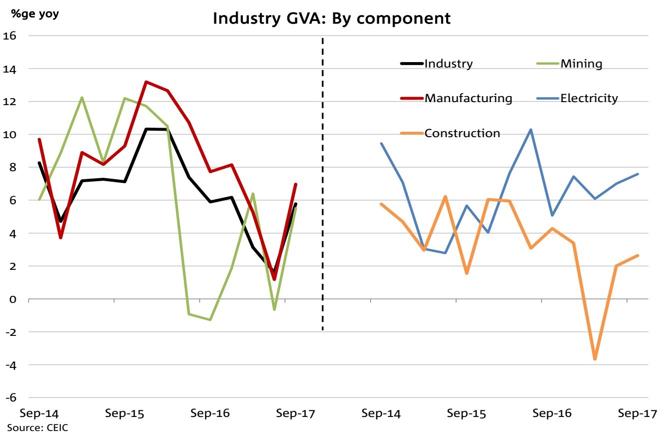
GVA by sector



Source: CEIC

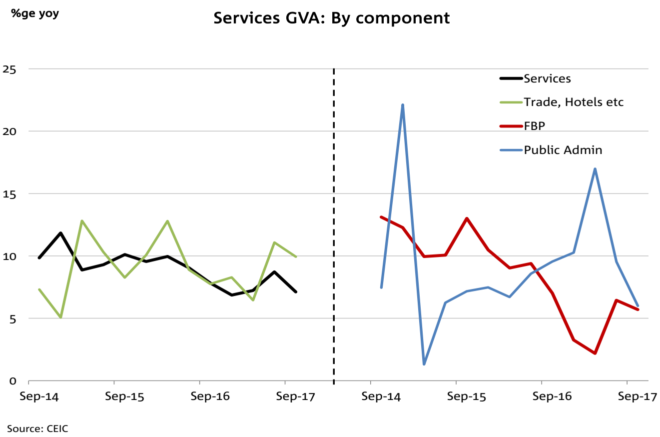
The standout has been the performance of the manufacturing sector, which grew by 7% yoy in the September quarter, well above 1.2% in June. It does appear that the negative impacts of demonetisation and the uncertainties regarding GST implementation are receding. Mining also performed strongly, although the employment-intensive construction sector only showed a slight bounce- from 2 to 2.6%.

Industrial sector components



Turning to services, there was a sharp deceleration in the public spending, from 9.5% in June quarter to 6% in the September quarter. This is not surprising, as the fiscal deficit for the April to October period was around 96% of the financial year's total, leaving limited scope for further fiscal spending. The finance, business and property services also eased, partly reflecting challenges in the real estate sector. Knight Frank reported a slowdown in the roll out of new residential projects across the 8 major cities in India during the April to September (2017) period.

Services sector components

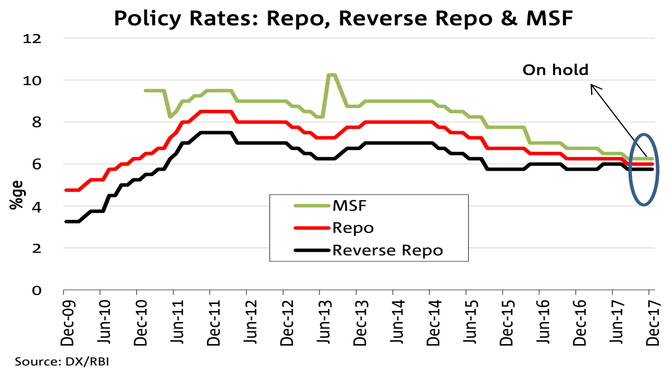


Monetary policy decision

At its 6th December Monetary policy meeting, the RBI:

- Maintained the policy (Repo) rate at 6.0%
- Held the Reverse repo and MSF rate at 5.75%, and 6.5% respectively

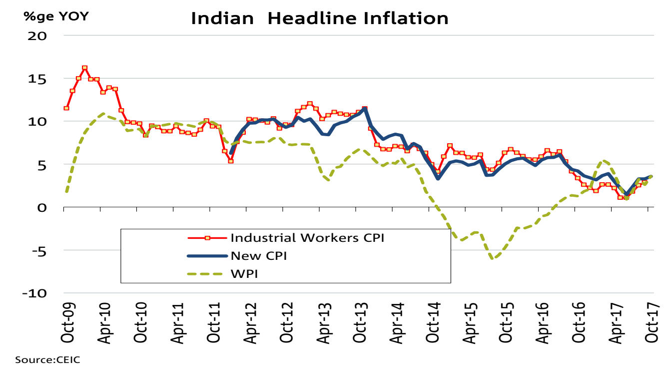
India policy rates



The decision went largely as expected. The RBI adopted a neutral policy stance: in other words, future actions would be data-dependent.

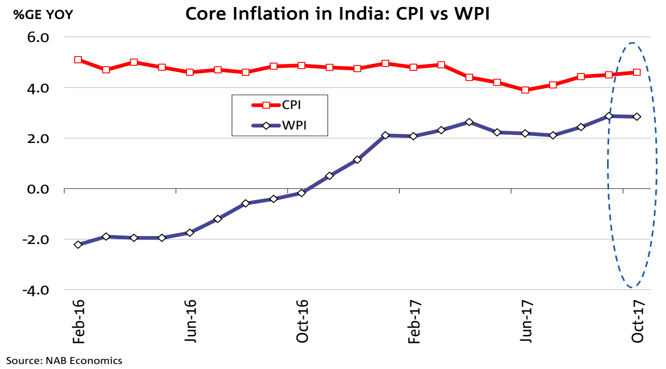
Consumer price inflation rose to 3.6% yoy in October, a 7 month high, driven largely by higher fuel prices. The fuel and light category rose 6.4% yoy , the highest since December 2013. Food prices rose, but at 1.9% were still restrained.

India headline and food inflation



Core inflation (ex food and fuel) remained largely stable around 4.5%, as a reversal of taxes on petroleum products by the central and state governments was offset by higher housing rents.

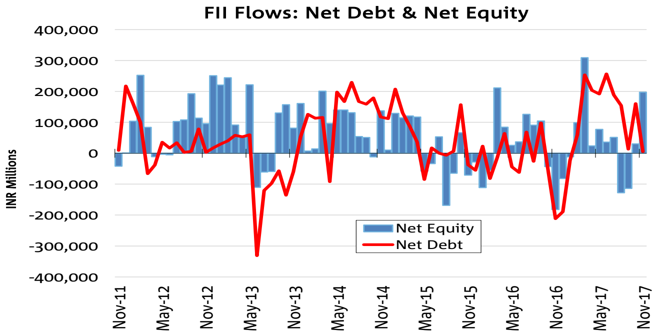
Core inflation



Further, the RBI highlighted a rise in inflation expectations among households for both the upcoming quarter as well as the year ahead. The recently released inflation expectations surveyof households for November 2017 indicated that the quarterly inflation expectation was 7.5% (up from

7.2%), and the annual expectation was 8.6% (up from 8%). These increases align with recent higher headline inflation outcomes.

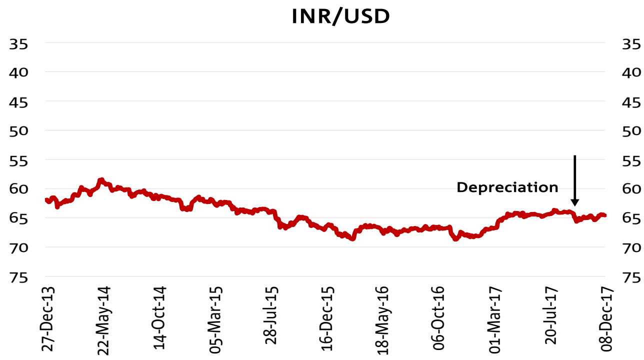
Portfolio Inflows



Source: DX

Foreign portfolio investors purchased INR 2.02tn of Indian securities during 2017; around 70% of these inflows was in debt funds. The RBI has built a USD31bn forward position in US dollars which act as an insurance policy in case there is a souring of foreign investor sentiment towards India. The forward position give the RBI the right – but not the obligation – to purchase dollars in the future, with most of the forwards expected to mature between 3 months to a year ahead. The Rupee was trading around INR64.50/USD at the time of writing.

Indian Rupee

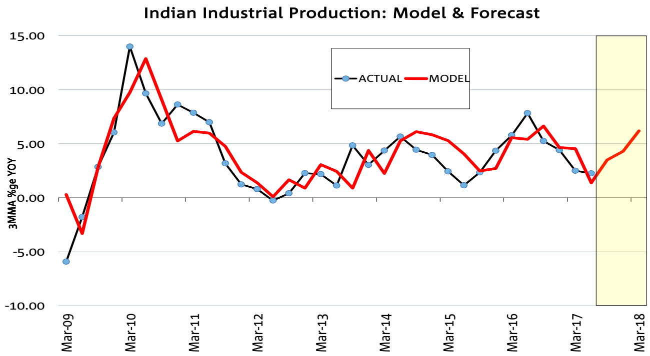


Source: Bloomberg

Outlook

The Indian economy is expected to improve in the quarters ahead. The negative impacts of measures such as demonetisation and initial implementation difficulties relating to the GST are expected to fade away. Further, the benefits of policies such as the provision of GST relief for exporters and SMEs as well as the public sector bank recapitalisation program are expected to boost credit growth and economic activity. Modelling by NAB Economics using a 'Leading indicator' approach suggests that industrial production is expected to improve to around 6.2%yoy in the March quarter, 2018.

Industrial production Outlook



Source: NAB Economics/CEIC

Looking ahead, NAB Economics is forecasting a 6.4% annual average growth outcome for 2017, followed by a somewhat quicker 7.1% and 7.3% in 2018, 2019 respectively.

At the recent monetary policy meeting, the RBI forecast headline inflation around 4.3-4.7% over the September 2017- March 2018 period, a 10bp rise from the October meeting. They highlighted both upside and downside risks to inflation. Higher fuel prices, possible higher pass-through of price rises by firms and fiscal measures pose upside risks. However, the negative output gap (growth below potential) and the lowering of the GST on a number of items would exert downward pressure.

NAB Economics is forecasting the RBI to remain on hold at 6% for an extended period, consistent with its neutral stance.

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