Economics

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RBI: Annual Report 2013-14

The RBI's Annual Report for 2013-14 provides an optimistic view on the state of the economy for FY15 and has taken the signals provided by economic data in the first 3-4 months positively though there is admission that there is a base effect that has provided some impetus to these numbers.

Overall assessment

- FY15 has begun on a promising note with IIP growth beginning to look up, while inflation on an average, so far, has been lower than in the corresponding period of the previous year.
- Monetary policy is providing a more stable environment in terms of interest rates, liquidity and credit conditions, with tangible efforts to improve resource flow to productive sectors. The latter includes cuts in statutory liquidity ratio (SLR) and exemptions from regulatory pre-emptions such as cash reserve ratio (CRR), SLR and priority sector lending (PSL) for issuing long-term bonds to finance loans to infrastructure and affordable housing.
- The Union Budget aims to keep the economy on the path of fiscal consolidation. However, strict adherence to fiscal discipline to avoid overshooting of expenditures and concerted efforts to mobilize tax and non-tax revenues, as also strong efforts on non-debt capital receipts will be necessary to attain these fiscal targets.
- Export growth has improved, while capital inflows remain adequate. Further, there has been a healthy accretion to foreign exchange reserves that helps insulate the economy against prospective shocks that may be transmitted onshore. The spike in global oil price following the civil war in Iraq was transitory. Upside risks to the oil prices, however, remain in the event of underlying geopolitical tensions resurfacing more strongly in the Gulf region. Overall, the exchange rate has been stable so far in 2014-15.

RBI outlook

- GDP growth is expected to be around 5.5% in 2014-15 from the sub-5% growth in the preceding two years.
    - In their earlier estimate there were more downside risks, which are fewer today.
    - The positive signals are:
        - Signs of improvement in mining and manufacturing activity,
        - Expected pickup in investment,
        - Improved availability of financial resources to private sector,
        - Lower draft of government on financial savings of the households amid fiscal consolidation,
        - Improved external demand and
        - Stabilizing global commodity prices are expected to support recovery.
    - However, downside risks could play out if global recovery slows, geopolitical tensions intensify or monsoon weakens again in the rest of the season. Deficiency in rainfall during the 2014 monsoon season so far poses some downside risks, but overall growth in FY15 is likely to be better than previous year with likely revival in industrial and construction activities.
- Inflation outlook remains unchanged and the RBI is committed to a disinflationary glide path of taking CPI inflation to 8 % by January 2015 and 6% by January 2016.

- Some stability in the exchange rate has mitigated the risk to inflation from exchange rate pass-through during FY15 so far.
- The revisions in administered prices during FY15, which include railway fare and freight fares apart from the staggered increases in diesel prices, could exert some pressure on generalized price levels.
- The smaller increases in the minimum support prices (MSPs) will help somewhat in restraining food price pressures.

- Going forward, the fiscal deficit is likely to reduce further in FY15. The budgetary targets are realizable, though concerted efforts will be necessary to achieve these targets.
- The CAD though is likely to widen from the levels in 2013-14, is expected to remain within the sustainable level. As such, the risks associated with twin deficit risks are expected to stay moderate.

Main challenges

- Lowering high food inflation through supply side management.
- Strengthening the monetary policy framework and transmission.
- Fiscal adjustment through revenue augmentation and improved tax administration will help to control the deficit.
- Managing the NPA cycle to improve soundness of the banking system

CARE's View

There are signs of a pick-up in the economy and the following is the position on the economy:

1. GDP growth will range between 5.2-5.5% and a clear view will emerge when the impact of monsoon on kharif crop is obtained.
   a. Industrial growth will move upwards and range between 3-4%. A critical element will be the revival of consumer demand during the festival and harvest seasons. So far industrial growth has not been broad based and influenced more by the base effect.
   b. While there is positive news on the investment front at the level of clearance of projects as well as fresh investment being envisaged, there has not been much traction in the debt and credit markets so far. We need to wait and watch developments in these segments.
2. Inflation pressures continue to exist and while stable oil prices and exchange rate is a big plus for the economy, the gradual increase in prices of manufactured goods and the uncertainty of crop production will have to be assessed. Based on present developments, WPI inflation will average 5-6% and CPI inflation 7-8% during the year.
3. Fiscal deficit will move along the desired path and it is unlikely that there will be a breach in deficit and hence any additional borrowing. However, growth in tax receipts will provide a clue on whether the government will be able to keep up with the targeted capex for the year.
4. CAD, as mentioned by the RBI will be higher than last year, though sustainable. CARE's initial estimate was around 2.5%, but the present trends in trade deficit for the first 4 months appear to suggest that it could be lower and move closer to 2%.
5. The rupee would continue to range between Rs 60-62/$ and our position has not changed since April.
6. GSec yields will be driven by developments on the monetary policy front and presently a range of 8.6-8.8% is expected to prevail though any rate cut or signs of a possible cut on account of inflation easing will lower the range to 8.4-8.6%

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