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ECOWRAP

M-O-M MANUFACTING MOMENTUM LOSES BUILDUP IN APRIL

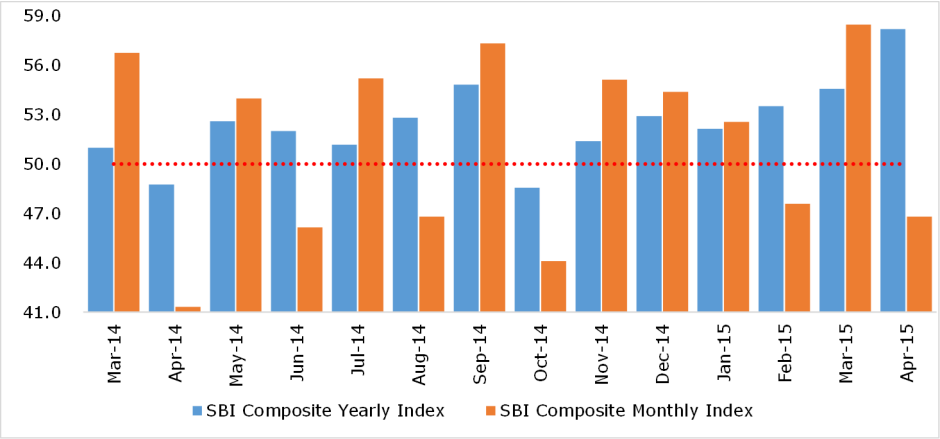
The yearly SBI Composite Index for April 2015 has now reached 61-month high at 58.2 (High growth) from 54.6 (Moderate growth) in March 2015, aided by low base value of April 2014. In contrast, the Monthly Index that inched up from 47.6 in February 2015 (Low decline) to 58.5 in March 2015 (High growth) has again shown a month on month poor performance of 46.8 (Low decline) in April 2015. Weak performance of the month on month Index suggests that the buildup in manufacturing momentum is still patchy and erratic. The recent RBI OBICUS survey in fact points out capacity utilization as well as new orders are still a laggard.

We believe while the medium term fundamentals look sound and promising, we need to take some corrective steps in the short term. For example, in the medium term, the successful completion of the coal and telecom auctions will provide a possible blip in bank lending books (early indications are positive). Added to this, recently, there was a successful completion of the bidding process for a large road sector project. Going forward, this may also be an added source of traction for bank lending. A modest number of corporates in the mid segment have also enjoyed a rating upgrades recently.

In particular, Infrastructure and Construction industry executing major infrastructure projects has been facing financial crisis. The fact is that the fundamentals governing the infrastructure projects have not been sound. A thorough review and corrective measures are therefore immediately required as is being done. The huge amount of claims due to cost and time overruns to be paid to these firms need to be released immediately. Presently, they have been blocked into disputes and time consuming litigations whereas the practice world over is to settle such matters through Dispute Resolution Boards so that the project work or the contractors do not suffer.

- The SBI Composite Index, a leading indicator for manufacturing activity in Indian Economy aiming to foresee the periods of contraction and the expansion. The Composite Index have mainly two indices namely SBI Monthly Composite Index and SBI Yearly Composite Index. Both the indices fulfill complementary purposes such as month on month sentiment movement vs. year on year growth forecast respectively.
- The complementary nature of these indices help user to gauge the sentiments in the markets. A consistent negative (positive) month on month forecast in the index will lead to negative (positive) growth rate in year on year index after a while.
- The yearly SBI Composite Index for April 2015 has reached 61-month high to **58.2** (**High growth**) from **54.6** (**Moderate growth**) in March 2015, aided by low base value of April 2014. In contrast, the Monthly Index that inched up from 47.6 in February 2015 (Low decline) to **58.5** in March 2015 (**High growth**) has shown a month on month poor performance of **46.8** (**Low decline**) in April 2015. Weak performance of the month on month index is attributed to seasonal factors.
- Manufacturing activity is getting robust with a positive growth for the fourth consecutive month (Since November 2014). IIP has averaged 4.3% growth since November 2014. However on the flip side, the Monthly Index that inched up from 47.6 in February 2015 (Low decline) to 58.5 in March 2015 (High growth) has again shown a month on month poor performance of 46.8 (Low decline) in April 2015. Weak performance of the month on month Index suggests that the buildup in manufacturing momentum is still patchy and erratic.
- Infrastructure and Construction industry executing major infrastructure projects in the country has been facing financial crisis. The fact is that the fundamentals governing the infrastructure projects have not been sound. A thorough review and corrective measures are therefore immediately required as is being done.

Chart 1: SBI Yearly and Monthly Composite Index



Source: SBI Research

Table 1: How to read SBI Composite Index

SBI Composite Index	Index Value
Less than 42	Large Decline
42 to 46	Moderate Decline
46 to 50	Low Decline
50 to 52	Low Growth
52 to 55	Moderate Growth
55 & Above	High Growth

Source: SBI Research

- The idea behind the recent policy changes for facilitating flow of infrastructure funds should be extended further to ensure that the construction firms do not continue to suffer due to adverse impact of the lacuna in project implementation. The huge amount of claims due to cost and time overruns to be paid to these firms need to be released immediately. Presently, they have been blocked into disputes and time consuming litigations whereas the practice world over is to settle such matters through Dispute Resolution Boards so that the project work or the contractors do not suffer.

SBI Composite Index Best Narrates the Manufacturing Activity

- The latest IIP numbers released by CSO for Feb'15 was accurately projected by the yearly SBI Composite Index for Feb'15 released on 17 Feb'15, two months in advance. The SBI Index, a leading indicator for manufacturing activity of Indian Economy for Feb'15 inched up to 52.9 (a nearly 7% growth compare to last year) from 52.1 in Jan'15.
- In similar line, the index too projected a revival in automobile sales, capital goods and consumer non-durables output to boost industrial production in Feb'15, which is also in line with our expectations.
- Interestingly, the validation of the SBI composite index also throws some more interesting facts on the manufacturing activity. Going by the directional validation, the yearly SBI composite Index scores 80.0%, For Mar'15 and Apr'15 the Index has also projected a robust growth of the manufacturing activity as the index inched up to 58.2 from 54.6 in Apr'15 and Mar'15, respectively.

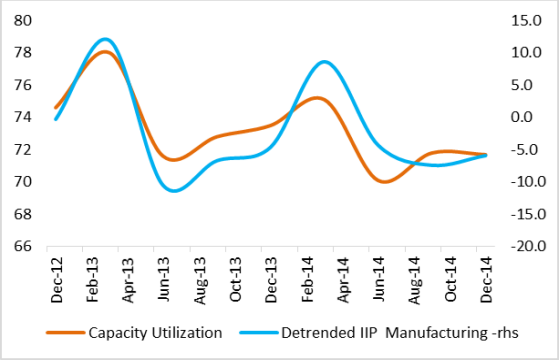
Table 2: Directional Validation and Index Value; SBI Yearly Composite Index vis-à-vis HSBC Manufacturing PMI (Since Oct'09)

Month	SBI Index	HSBC PMI	SBI Index		HSBC PMI	
Apr-14	48.7	51.3	✗	0	✗	0
May-14	52.6	51.4	✓	1	✓	1
Jun-14	52.0	51.5	✓	1	✗	0
Jul-14	51.2	53.0	✗	0	✓	1
Aug-14	52.8	52.4	✗	0	✗	0
Sep-14	54.8	51.0	✓	1	✓	1
Oct-14	48.6	51.6	✓	1	✗	0
Nov-14	51.4	53.3	✓	1	✓	1
Dec-14	52.9	54.5	✓	1	✓	1
Jan-15	52.1	52.9	✓	1	✓	1
Feb-15	53.5	51.2	✓	1	✓	0
Mar-15	54.6	52.1				
Apr-15	58.2					
Directional Validation			80.0%		48.4%	

RBI OBICUS Survey! No Immediate Reason to Cheer!

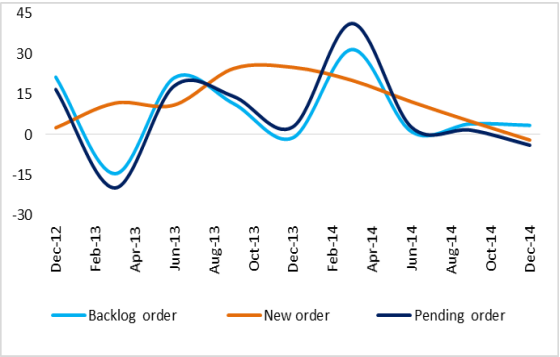
- There is broad co-movement between capacity utilization (CU) and de-trended IIP manufacturing. However, the CU at the aggregate level, remained at the same level in Q3 FY15 as that of the previous quarter. However, it stood at a lower level from that in same quarter of the previous year.
- The new orders growth showed a decline and became negative in Q3 FY15 both on a year-on-year and quarter-on-quarter basis.
- The decline in finished goods inventory to sales ratio to 17% in Q3 FY15 shows draw down of the finished inventory may be due to combined effect of rise in sales and halt in production, where the second one dominates at current scenario.
- Though the result throws no positive sign and dashes any immediate revival hope of the economy, we do believe that the slow down is bottoming out and would start reviving Q2FY16 onwards.
- The successful completion of the coal and telecom auctions will provide a possible blip in bank lending books (early indications are positive). Added to this, recently, there was a successful completion of the bidding process for a large road sector project. Going forward, this may also be a added source of traction for bank lending. It may be noted that the second round of coal auctions are going to start in end April and end in mid June.

Chart 2: Capacity Utilization vs. Mfg.



Source: SBI Research

Chart 3: Order Book (Y-o-Y %)



Source: SBI Research

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