Decide with Confidence

Dun & Bradstreet

ECONOMY OBSERVER

Issue 24 | April 2009

View from the top

Dun & Bradstreet's Macro Economic Forecasts

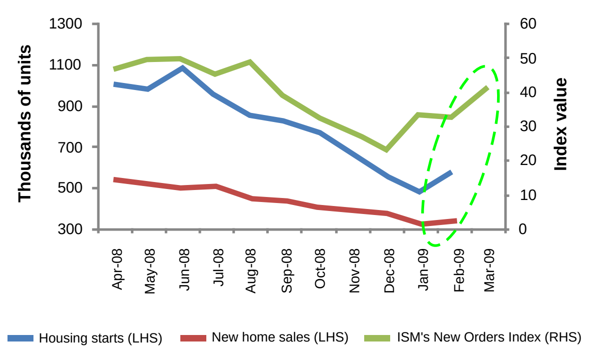
	Forecast	Latest Period
Inflation W.P.I	(-)0.5% - 0.0% (Apr-09)	0.3% (Mar-09)
Inflation C.P.I (I.W)	8.5% - 9% (Mar-09)	9.6% (Feb-09)
INR/US$	49.8 - 50.2 (Apr-09)	51.2 (Mar-09)
I.I.P Growth	0.0% - 1.0% (Mar-09)	-1.2% (Feb-09)
15-91 day's T-Bills	4.5% - 5.0% (Apr-09)	4.6% (March-09)
10 year G-Sec yield	7.0% - 7.3% (Apr-09)	7.3% (March-09)
Bank Credit*	17.4% - 17.6% (Apr-09)	17.3% (Mar-09)

All figures are monthly averages — **Refers to End period*

Dun & Bradstreet's GDP Forecasts

	Forecast (Q4 FY09)	Latest Period (Q3 FY09)
GDP	6.3%	5.3%
Agriculture	2.5%	-2.2%
Industry	3.3%	2.4%
Services	8.7%	9.9%

US Economic Indicators: Some hope for recovery



Source: Institute for Supply Management (ISM) & US Census Bureau

The sharp contraction in economic activity- evident during the past few months- is now beginning to witness some abatement. Modest improvement in steel and cement production, positive growth in auto sales and resilient performance of the capital goods sector point towards incipient signs of stability returning back to the domestic economy. While it may be too early to conclude a sustained demand recovery in the economy based upon these indicators, they do provide a base for the inevitable economic recovery to take place. Downside risks to demand continue to exist as uncertainty on the employment and political front still prevails. D&B expects demand conditions to remain subdued in the near future.

The de-seasonalised data for IIP reflects that industrial production, although muted, has witnessed positive growth of 0.2% (m-o-m) during Feb-09. This, along with upward revision in IIP data for Jan-09 provides a glimmer of hope. Moreover, double digit growth registered by the capital goods for the second consecutive month in Feb is a positive sign. Recent data available also points to some buoyancy in investment proposals in the last quarter of the previous financial year, which may provide some cushion to overall industrial production in the forthcoming months. However, declining exports will continue to affect industrial production adversely. Further, increased risk aversion among banks has affected the credit availability for medium and small enterprises, thereby putting additional downward pressures on production.

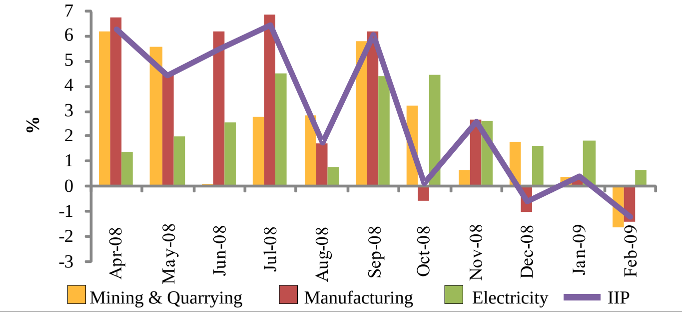
With high risk aversion amongst banks, their exposure to Government securities is likely to increase in the near future. Further, the huge market borrowing by the Government during H1 FY10 is likely to put upward pressure on the G-sec yield. This in turn has the potential to crowd out private investment once recovery sets in by the second half of FY10. Nonetheless, Government's decision to raise only one third of its borrowing target for FY10 in the H2 FY10 is likely to ensure credit availability for the private sector during the same period.

On inflation front, a confluence of factors such as moderation in prices of commodities, subdued demand and high base are likely to pull down the headline inflation to sub-zero level in Apr-09. Furthermore, it is likely to remain at sub-zero level for some time. This will give some headroom to the RBI for further reduction in key policy rates in its forthcoming monetary policy review.

Contents

Real Economy

Index of Industrial Production



Source: CSO

- IIP growth drops to a record low of -1.2% during Feb-09; base effect in play.
- IIP growth numbers for Jan-09 revised upwards to 0.4% from the initial estimate of -0.5%.
- Nine out of Seventeen industry groups within IIP basket registered negative growth during Feb-09.
- Capital goods registers double digit growth for the second consecutive month; Production of Capital goods sector grew by 10.4% during Feb-09 after witnessing growth of 15.1% in Jan-09.
- Infrastructure growth improves marginally; Index of six core-infrastructure industries grew by 2.2% in Feb-09 as compared to 1.5% in Jan-09.

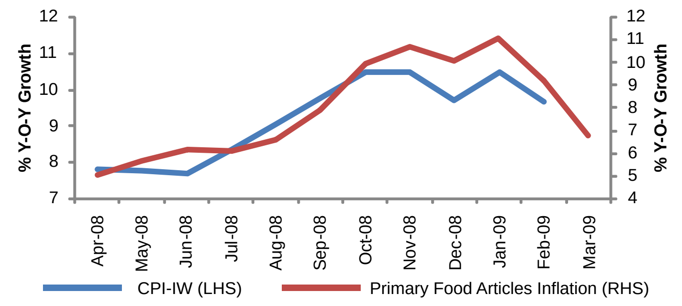
		Actuals	
	Forecast	Latest Period	Previous Period
I.I.P Growth	0.0% - 1.0% (Mar-09)	-1.2% (Feb-09)	0.4% (Jan-09)

While expectations for IIP growth in Feb-09 were subdued, the negative growth of 1.2% could in some part be attributed to a high base effect. In fact, looking at de-seasonalized data, IIP has grown by 0.2% (m-o-m) in Feb-09. Growth in the intermediate goods sector declined for the seventh consecutive month in a row on y-o-y basis. However, it increased by around 1% (seasonally un-adjusted) on m-o-m basis during Feb-09, against the usual declining trend in last few years. Moreover, after adjusting the data for seasonality, the index for intermediate goods registered an increase of 4% (m-o-m) and provides some glimmer of hope. Besides, the D&B's Business Optimism Index for Q2 2009 also reveals that optimism in the intermediate goods sector has improved slightly as compared to the previous quarter. This could be viewed as incipient signs of stability coming into the economy where production may witness consolidation in the forthcoming quarters, thus laying ground for a recovery in H2 FY10.

Although on one hand the resilient growth in the capital goods sector is likely to support the overall industrial production, declining exports will continue to have adverse impact on production of the export oriented sectors like cotton textile, leather etc. Moreover, subdued domestic demand conditions in the short run are likely to weigh on industrial production. Thus, while some stability is likely to be restored going forward, the IIP growth is expected to remain muted during most of H1 FY10.

Price Scenario

Fall in primary articles inflation leads to moderation in CPI-IW



Source: Ministry of Commerce

- The WPI inflation moderated to 0.3% (y-o-y) during Mar-09 from 3.2% during Feb-09.
- Given the lower global oil prices, fuel group registered deflation of 6.1% during Mar-09.
- A significant moderation in primary food articles inflation (particularly fruits & vegetables) coupled with a fall in prices of non-food articles and minerals led to the further slowdown in the primary articles inflation to 3.9% during Mar-09 as against 6.8% during Feb-09.
- Inflation in food grains too receded to 10.0% during Mar-09 from 11.9% during Feb-09.
- Inflation in manufactured products declined to 1.3% during Mar-09 from 4.5% during the previous month owing to a sharp fall in prices of basic metal alloys & metal products.
- The consumer price inflation for industrial workers (CPI-IW) retreated to 9.6% during Feb-09 from 10.5% during Jan-09.

		Actuals	
	Forecast	Latest Period	Previous Period
Inflation W.P.I	(-)0.5% - 0.0% (Apr-09)	0.3% (Mar-09)	3.2% (Feb-09)
Inflation C.P.I (I.W)	8.5%-9.0% (Mar-09)	9.6% (Feb-09)	10.5% (Jan-09)

All figures are monthly averages

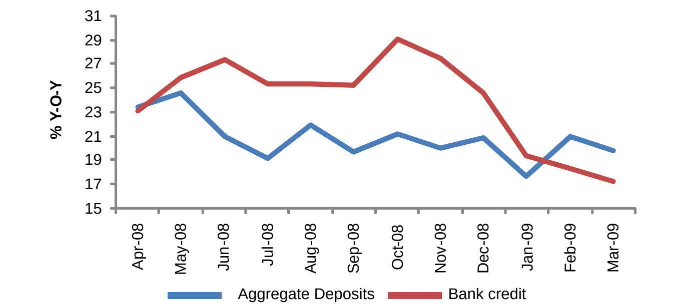
As per the Agriculture ministry data, prices of various primary food and non-food articles such as wheat, ragi, maize, cotton, copra and sunflower are below minimum support price set by the Central Government owing to ban on exports and piling up of food grains stock in the warehouses. This might have led to moderation in primary articles inflation during Mar-09. Further, prices of primary food articles such as fruits & vegetables, milk, eggs, meat & fish etc, which have already began to moderate, eased inflationary pressures in primary articles to a certain extent.

Given the significant fall in primary articles inflation, the consumer prices inflation for industrial workers is expected to moderate in the coming months. D&B expects consumer price inflation for industrial workers to remain around 8.5%-9.0% in Mar-09. Going forward, the gap between CPI & WPI inflation might narrow towards the end of the current calendar year.

Given the sustained moderation in the inflation of primary articles and a strong statistical base effect, the headline inflation is expected to ease further and touch sub-zero level in Apr-09. It is likely to remain at sub-zero level for quite some time. D&B therefore expects the WPI inflation to average between -0.5%-0.0% during Apr-09.

Money & Finance

Growth in credit and deposit of SCBs



All figures stand for month ended data
Source: RBI

- The Government announced to issue G-sec worth Rs 2,410 bn during H1 FY10.
- 15-91 day T-Bill yield inched up further to 4.4%-5.2% for the week ended 27-Mar-09 as against 4.3%-4.8% for the week ended 27-Feb-09.
- In order to restrict surge in G-sec yields consequent to the huge market borrowing programme of the Government, the RBI is expected to inject Rs 1,220 bn in H1 FY10 through special & open market operations and MSS unwinding.
- Liquidity conditions remained comfortable during most part of Mar-09 as was apparent from easing of call rates and higher recourse to reverse repo window by banks.
- The BSE Sensex surged to 11,284.7 points as on 15-Apr-09.

		Actuals	
	Forecast	**Latest Period**	**Previous Period**
15-91 day's T-Bills	4.5%-5.0% (Apr-09)	4.6% (March-09)	4.6% (Feb-09)
10 year G-Sec yield	7.0%-7.3% (Apr-09)	7.3% (March-09)	6.9% (Feb-09)
Bank Credit*	17.4%-17.6% (Apr-09)	17.3% (Mar-09)	18.3% (Feb-09)

All figures are monthly averages **Refers to End period*

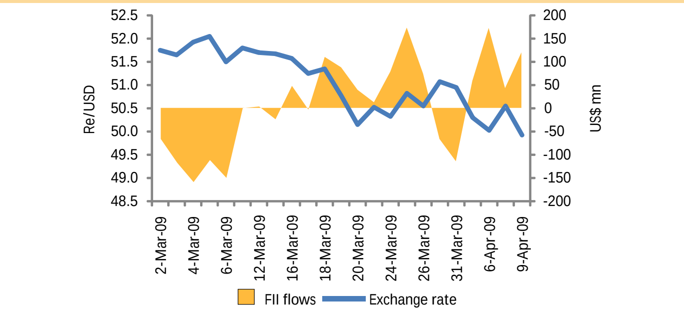
The huge market borrowing by the Government within a span of six months might exert upward pressure on interest rates and has the potential to crowd out private sector investment. Nonetheless, the Government's decision to meet only a small portion (one-third) of its borrowing target in H2 FY10, is likely to ensure availability of funds to the private sector during this period. This would provide some respite to the currently muted private sector investment which is expected to witness some turn around in H2 FY10.

The high risk aversion amongst banks coupled with the weak net interest margin consequent to the rising pressure to reduce lending rates might lead some banks to increase their exposure to G-sec in the near future. As a result, despite some reduction in PLR, growth in bank credit might remain low in the near future. Further, the data reveals that deposits grew by 20.0% (y-o-y) for the week ended 27-Mar-09 - higher than the 17.3% growth in bank credits for the same period. Going forward, the strong inflow of deposits to banks coupled with expected rise in bank's exposure to G-sec might result in the lower incremental credit deposit ratio.

Given the sharp moderation in the WPI inflation and model code of conduct in place, the RBI is likely to announce further reduction in key policy rates in its forthcoming monetary policy review.

External Sector

Exchange Rate and FII Inflows



Source: RBI & SEBI

- In Feb-09, India's exports declined by 21.7% (y-o-y), while imports declined at a faster pace of 23.3% (y-o-y), resulting in shrinking of trade deficit to US$ 4.9 bn.
- The current account deficit amounted to US$ 14.6 bn during Q3 FY09, the highest quarterly deficit since 1990.
- The capital account balance turned negative during Q3 FY09 for the first time since Q1 FY99.
- India's total external debt stock increased by 2.8% to US$ 230.9 bn at the end of Dec-08 over end Sep-08.
- The ratio of foreign exchange reserves to total external debt as at end Dec-08 stands at 110.9 %.
- India's real effective exchange rate (REER) remains undervalued at 94.0 (as on 19-Feb-09).

		Actuals	
	Forecast	**Latest Period**	**Previous Period**
INR/US$	49.8 – 50.2 (Apr-09)	51.2 (Mar-09)	49.2 (Feb-09)

All figures are monthly averages

With almost all the economies across the world witnessing slowdown, demand conditions have deteriorated significantly and in turn affected world trade scenario. Moreover factors like shortage of trade finance and a rise in protectionist policies adopted by various countries are going to dampen world trade further. According, to recent estimates by the World Trade Organisation (WTO), world merchandise trade is likely to fall by around 9.0% in volume terms in 2009 (i.e. where price changes have been removed from the calculation), with developed economy exports falling by around 10.0% on average and developing country exports shrinking by 2-3%.

Given the gloomy world trade outlook and subdued demand conditions in the domestic economy, India's export and import scenario too is likely to remain grim in short-term.

In the forex market, gains in the domestic stock markets and some resumption in the FII inflows is going to provide support to the rupee which is expected to appreciate marginally from the current levels and average around 49.8-50.2 during Apr-09. A confluence of factors such as favourable interest rate differential, comfortable ratio of foreign exchange reserves to total external debt and undervalued real effective exchange rate are likely to help the rupee value to shore up in the medium to long term period.

Please send your feedback to Yashika Singh, Head-Operations, Economic Analysis Group
Dun & Bradstreet Information Services India Pvt. Ltd., ICC Chambers, Saki Vihar Road, Powai, Mumbai 400 072
Tel: 91-22-28574190 / 92 / 94 Fax: 91-22-28572060 Email: D&BEconomyObserver@mail.dnb.co.in www.dnb.com