



Decide with Confidence

Dun & Bradstreet

# ECONOMY OBSERVER

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The Indian economy grew by more than 9% during the first half of the current fiscal, supported by strong performances witnessed in the industrial (9.8%) and services (10.4%) sectors. The construction and trade, hotels, transport & communications sectors, in particular, grew at impressive rates of 10.9% and 11.7% respectively.

Figures for Q2 FY08 reveal an 8.9% growth in the economy. As we had indicated in our September 2007 issue, growth in GDP during Q2 FY08 - although strong - does represent a slowdown from the previous quarter's growth of 9.3%. Further, even though industrial production data for the first month of Q3 FY08 point towards an 11.8% growth in IIP, we believe that this is the low base effect at play.

On the monetary front, growth in money supply at 22.8% (as of 23-Nov-07) remains significantly higher than the target growth of 17.5% despite the RBI's attempt to suck out liquidity through a hike in the Cash Reserve Ratio. Further, with the 25 basis points reduction in the Fed rate, sustained foreign fund inflows may follow. However, given the current international interest rate scenario, we do not expect the RBI to hike any of its key interest rates. The RBI may therefore have to find suitable measures to deal with excess liquidity without attracting further foreign funds. One of the possible options - resorting to a hike in the auction size under the Market Stabilisation Scheme could put further pressure on the fiscal front.

Inflation has not yet borne the complete pass through of surging international crude oil prices. As we have stated in previous issues, given the fiscal costs of issuing oil bonds, the sustainability of adopting this route remains a key concern.

Given the current elevated levels of interest rates, the strong rupee, slowing exports (barring figures for the month of Oct 07), higher imports and the high base of the Nov 06 - Mar 07 period, we expect growth in IIP to moderate and stand at an average of about 9.5% in FY08, a significant decline from the average of 11.5% recorded during FY07. We maintain our stance on GDP; we expect growth to moderate during H2 FY08 and average at around 8.7% during FY08.

### Dun & Bradstreet's Economy Forecast

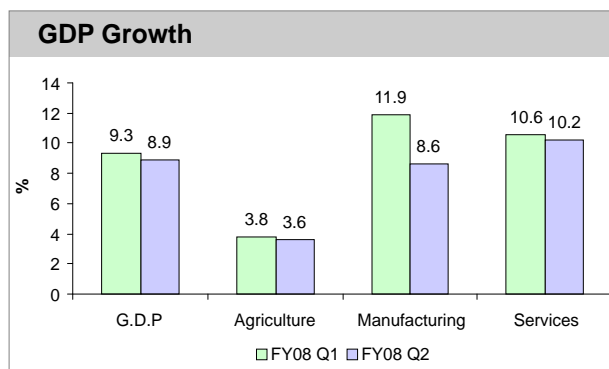
	FORECAST	ACTUALS	
		Latest Period	Previous Month
Inflation (W.P.I)	3.3%- 3.5%(Dec-07)	3.22%(Nov-07)	3.03%(Oct-07)
IIP Growth	5.0%-6.0%(Nov-07)	11.8%(Oct-07)	6.8%(Sept-07)
15-91-day T-Bills	7.0%-7.3%(Dec-07)	7.37%(Nov-07)	6.68%(Oct-07)
INR/US\$	39.2-39.4(Dec-07)	39.44(Nov-07)	39.51(Oct-07)

*All figures are monthly averages, (y-o-y)*

## Real Economy

### Industrial production at 11.8%; Low base effect at play

The Indian economy grew by 8.9% during Q2 FY08, driven by resilient performances of both the industry (9.1%) and the services sectors (10.2%). The agricultural sector too continued to display a healthy performance and grew by 3.6%, backed by favourable monsoons and a 4.6% increase in the area under cultivation. On a sectoral basis, the construction and trade, hotels, transport & communicators sectors, in particular, grew at impressive rates of 11.1% and 11.4% respectively. However, manufacturing sector growth at 8.6%, represents a significant slowdown from the previous quarter, when growth stood at 11.9%. It is possible that high interest rates have had an impact on the manufacturing sector, causing growth to slowdown considerably.



Source: CSO

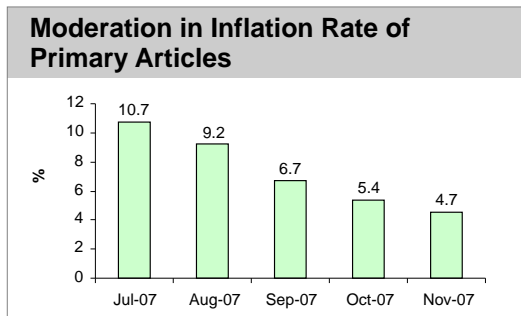
The impact of a tight monetary policy on consumer spending is also evident from the declining contribution of private final consumption expenditure to overall GDP. Private final consumption expenditure contributed 55% of GDP growth, down from almost 59% during the previous quarter. Private consumption expenditure is likely to continue to be impacted by high interest rates during H2 FY08. Investment, however, continued to remain strong, contributing approximately 30% of GDP growth during Q2 FY08.

Industrial production data for the first month of Q3 FY08 reveals an 11.8% increase in IIP; however this could be attributed to the low base of the previous year. The manufacturing sector, which accounted for 92% of the increase in IIP, grew by 13.3% in Oct 07 as compared with a growth rate of 3.8% in Oct 06. Given the current domestic scenario of high interest rates, a strong rupee and therefore cheaper imports, the economy is likely to witness a moderation in growth during the months to come. We expect the Index of Industrial Production to moderate during subsequent months given the high base of the previous year. We expect IIP to have grown within the range of 5%-6% in Nov 07.

## Price Scenario

### Primary articles inflation continues to moderate during Nov 07

Although, inflation averaged 3.22% (y-o-y) during Nov 07 as compared to 3% (y-o-y) in the previous month, it is still lower than the inflation rate recorded in Nov 06 (5.38%) as well as the RBI target of 4-4.5%. Low inflation as compared to the year ago period is primarily due to a moderation in manufactured product prices as well as almost no change in fuel prices. Inflation in manufactured products, which accounted for around 72% of the overall inflation, moderated to 3.85% from 5.18% in Nov 06. Domestic fuel prices have not yet borne the pass through of high global crude oil prices. Fuel price inflation therefore remained unchanged, pulling down the overall inflation rate.



Source: Ministry of Commerce

Primary articles inflation also moderated to 4.7% during Nov 07 (as compared to 7.2% in Nov 06), primarily due to a high base effect. Amongst the food articles, fruits and vegetables prices declined substantially during Nov 07, registering a negative growth of 3.44%. Prices of non-food articles, however, continued to rule above 10%.

However, as per the latest available data, inflation for the week ended 01-Dec-07 has increased to 3.75%, driven by increases in fruits & vegetables prices as well as fuel prices. We expect this trend to continue during subsequent months, given that domestic fuel prices are yet to bear the full pass through of international prices.

We expect WPI inflation to average at around 3.3-3.5% during the month of Dec 07.

## Money & Finance

### Money supply at 22.8% despite hike in CRR

Money supply continued to grow at a high rate of 22.8% (as of 23-Nov-07) despite the 50 basis points hike in the CRR that absorbed approximately Rs 150 bn from the banking system.

However, liquidity conditions in the banking system did tighten, resulting in a marginal firming up of G-sec yields. The 15-91 day treasury bills yield surged to 7.36-7.60% during Nov 07 as against 6.25-7.35% during Oct 07. Call rates in the inter-bank money market also surged to 7-8%, above the Liquidity Adjustment Facility corridor. The RBI therefore resorted to liquidity injections in the banking system through repo auctions, so as to prevent call rates from rising any further.

Concerns over the sub-prime crisis weighed down the sentiment in the global stock markets, leading foreign investors to pare positions in the domestic stock market. As a result, the domestic stock market witnessed FII outflows of US\$ 1.45 bn, causing the Sensex to decline below 19,000 points during Nov 07. The Sensex, however, recovered during the first week of Dec 07, crossing the 20,000 mark on 11-Dec-07. The further 25 basis points reduction in the US Fed rate may lead to strong capital inflows in the domestic stock market, in turn stimulating money supply growth. However, given the widening interest rate differential (between India and the US), the RBI may have to find suitable measures to deal with excess liquidity without attracting further foreign funds. In the short run we expect 15-91 day T-bills yield to be in the range of 7.0-7.3% in Dec 07.

Monetary Indicators				
	FY07	Sep 07	Oct 07	Nov 07***
M3*	21.3	21.0	22.5	22.8
Bank Credit*	28.0	21.9	22.5	23.3
Non Food Credit*	28.4	22.1	23.0	23.9
Prime Lending Rate (%) (Max.)	12.5	13.3	13.3	13.3
5 year G-secYield (%)	7.9	7.8	7.7	7.8%#
Inflation (%)	5.4	3.3	3.0	3.2

\* Figures are percentage y-o-y growth;

\*\*\* As on November 23, 2007; # For the week ended November 16, 2007

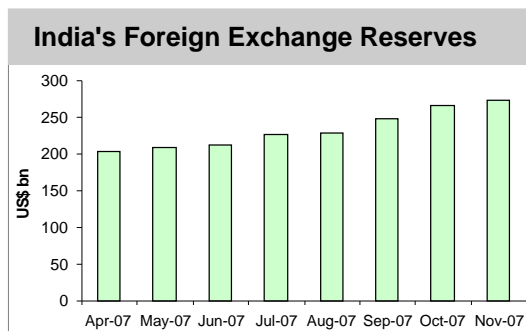
All figures (excluding inflation) are as at end of the month

Source: RBI

## External Sector

### Exports witness an impressive growth during Oct 07

During Oct 07, exports in dollar terms witnessed a substantial growth of 35.65% (y-o-y) as compared to 19.3% (y-o-y) in Sep 07. In rupee terms too, exports grew impressively by 17.88% (y-o-y) in Oct 07 as compared to 4.31% (y-o-y) in the previous month. However, despite the impressive growth in exports witnessed in Oct 07, it is expected that exports during FY08 would be lower than the target of US\$ 160 bn. In Oct 07, imports (in dollar terms) grew by 24.27% (y-o-y) as compared to 2.31% (y-o-y) in Sep 07, primarily driven by a sharp rise in growth of non-oil imports, which grew by 28.8% in Oct 07 as against a decline of 0.15% (y-o-y) in the previous month. In rupee terms, imports grew by 7.99% during Oct 07. The trade deficit widened to US\$ 44.41 bn during Apr-Oct 07 as compared to US\$ 32.94 bn during the corresponding period of the previous year.



Source: RBI

The rupee did not make significant gains during Nov 07 due to a substantial increase in dollar demand by oil importers as international oil prices witnessed a sharp surge. Foreign capital outflows from the domestic stock market further weighed down the value of the rupee. Further, the RBI also intervened in the domestic forex market at regular intervals thereby ensuring that the rupee remained around the 39.4 to a US\$ mark. However, India's foreign exchange reserves increased to US\$ 273.52 bn (as on November 30, 2007) from US\$ 266.52 bn (as on November 2, 2007). Given the 25 basis points reduction in the US Fed rate, a strong inflow of foreign funds could result in a further appreciation of the rupee, consequently increasing the pressure on the RBI for intervention in the forex market. Besides, a strong rupee could affect the exports growth, thus widening the trade deficit further. We expect the rupee to be in the range of 39.2-39.3 during the month of Dec 07.

Please send your feedback to Yashika Singh - Leader, Economic Analysis Group

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