



Decide with Confidence

Dun & Bradstreet

# ECONOMY OBSERVER

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While D&B anticipated a slowdown in IIP growth, the decline of -0.42% in IIP during Oct-08 came as a surprise and is disappointing. However, the decline in IIP could be partly attributed to the high base of the previous year. Nonetheless, on account of high interest rates and raw material prices during the first half of the current fiscal coupled with subdued demand conditions, the IIP growth almost halved to 4.13% during Apr-Oct 08. Moreover, with countries all over the world grappling with the ripple effects of the global financial crisis, overseas demand for Indian goods has been hampered significantly leading to a slowdown in India's exports which fell by 12% (y-o-y, US\$ terms) during Oct-08. Subdued domestic demand conditions, slowdown in exports, are likely to have a strong bearing on India's economic growth, which has already begun to moderate as reflected in slowdown in GDP growth of 7.6% during Q2 FY09 as compared to 9.34% in Q2 FY08.

As the spillover effects of global financial crisis and global slowdown on the Indian economy have begun to unfold, the Government and RBI have taken a slew of fiscal and monetary measures to help boost domestic demand and arrest the rapid fall in the economic growth. The RBI's stimulus package included a 100 bps cut in the repo and reverse repo rate along with a slew of other measures mainly intended to boost the flow of credit to exporters, SMEs and real estate. These monetary measures were supplemented by a number of fiscal initiatives that included a 4% cut in ad valorem Cenvat rates across the board for all items other than petroleum, 2% interest subvention for exporters, and an additional allocation of Rs 14 bn to clear the entire backlog in TUF (Technology Upgradation Fund) Scheme. While the cut in repo and reverse repo is likely to help stimulate demand, the other monetary and fiscal measures will provide some relief to ailing sectors. Moreover, additional Plan expenditure of up to Rs 200 bn in the current fiscal and full utilisation of funds for existing projects are likely to boost demand and support economic growth. However, the timely and effective implementation of these measures is vital in order to achieve the desired objectives.

Going forward, the Government is likely to announce some more counter-cyclical measures to arrest slowdown in economic activity and alleviate raising concerns on significant downturn in economic growth. D&B expect the RBI to reduce policy rates further to stimulate demand. Although the substantial easing of RBI's monetary stance coupled with considerable increase in Government expenditure will indeed help to uplift the sentiment, they are not expected to completely offset the adverse impact of the global financial and economic crisis on India's growth prospects in the short run.

### Dun & Bradstreet's Macro Economic Forecasts

	FORECAST	ACTUALS	
		Latest Period	Previous Month
<b>Inflation (W.P.I)</b>	6.80%-7.00%(Dec-08)	8.53%(Nov-08)	10.59%(Oct-08)
<b>IIP Growth</b>	0.50%-1.50%(Nov-08)	(-)0.42%(Oct-08)	5.45%(Sep-08)
<b>15-91-day T-Bills</b>	6.70%-6.90%(Dec-08)	6.87%(Nov-08)	7.52%(Oct-08)
<b>INR/US\$</b>	48.50-48.80(Dec-08)	49.00(Nov-08)	48.64(Oct-08)

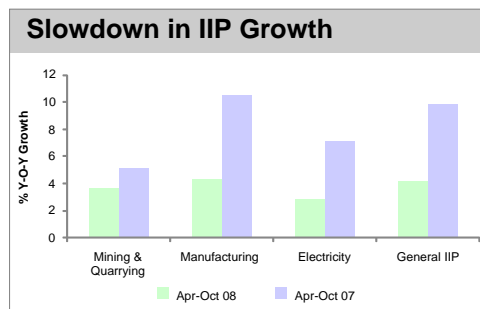
*All figures are monthly averages*

## Real Economy

### IIP growth turns negative

GDP registered 7.6% (y-o-y) growth during Q2 FY09 as against 9.34% during Q2 FY08. Given the slowing demand in domestic markets, high interest rates and elevated raw material prices, GDP growth was bound to moderate. The impact of above mentioned factors was primarily felt in manufacturing sector which grew by just 4.96% during Q2 FY09 (as against 9.43% during Q2 FY08), causing further moderation in industrial growth.

Further, the industrial production data for Oct-08 revealed that IIP growth turned negative to -0.42% for the first time in 15 years. While D&B anticipated a slowdown in IIP growth, the decline of -0.42% in IIP came as a surprise. The manufacturing sector registered a decline of 1.18% during Oct-08. The dip in manufacturing output can be partly attributed to the high base of the previous year. Besides, the rationalisation of inventory by manufacturers in the wake of subdued demand conditions in the domestic and international markets might have taken toll on manufacturing activity during the month of Oct-08.



Source: CSO

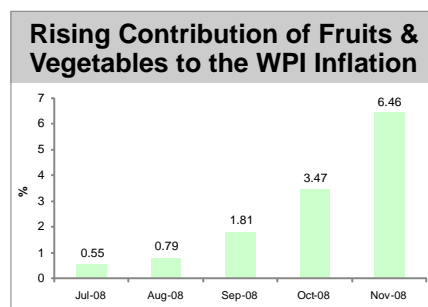
While there is increasing evidence of slowing consumption demand, the data reveals that investment demand remains modest and is supporting the economic growth. However, given the global economic slowdown, domestic investment demand is likely to moderate and consumption demand to remain subdued in the coming quarters. In light of this, various fiscal and monetary measures were announced which are expected to provide the required impetus to the overall growth of the Indian economy. In particular, the measures to step up Government spending and focus on infrastructure development are critical steps to stimulate demand and provide additional employment opportunities. However, the full impact of these measures on economic activity will unfold over a period of time and hence growth may remain subdued in the near future. D&B therefore expects IIP to have grown within the 0.5-1.5% range during Nov-08.

## Price Scenario

### Prices of primary food articles remain elevated

The WPI inflation which peaked at 12.72% (y-o-y) during Aug-08 has witnessed substantial moderation in the past three months due to a sharp decline in global oil prices as well as consistent moderation in prices of manufactured products. The headline inflation moderated to 8% for the week ended 29-Nov-08, taking the average inflation for the month of Nov-08 to 8.53%.

With global oil prices plunging to US\$ 53.24 during Nov-08 (from a peak of US\$ 145 per barrel during Jul-08), prices of imported mineral oils, particularly aviation turbine fuel, naphtha and furnace oil witnessed a substantial decline, in turn pulling down inflation in mineral oils to 8.66% during Nov-08 from 20.31% during Oct-08. The significant moderation in mineral oils prices led to a reduction in fuel group inflation, with its contribution to the headline inflation dropping to 10.63% during Nov-08 from 18.39% during Oct-08. Moreover, given the persistent moderation in global oil prices and the recent cut in prices of petrol and diesel, inflation in fuel group is expected to come down further in the coming weeks.



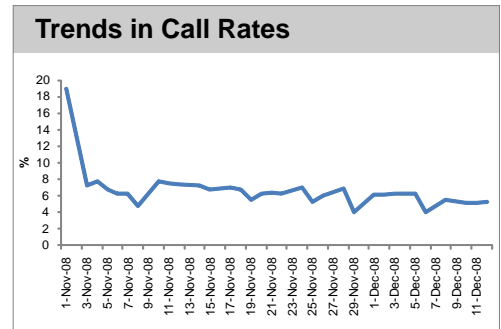
Source: Ministry of Commerce

Prices of primary food articles, on the other hand, continued to surge during Nov-08 driven by a sharp rise in prices of fruits & vegetables and food grains. Inflation in fruits & vegetables, which soared to almost 18.87% during Nov-08 (from 12.59% during Oct-08) partly due to low base of the previous year, contributed 6.46% to the headline inflation. However, given that the impact of fiscal measures taken by the government during Q1 FY09 to rein in prices is likely to come into effect now (with a lag), prices of primary food articles are expected to moderate after couple of months. This coupled with the better production prospects for the Rabi season is expected to moderate inflation in primary food article in the near future. This apart, the recent cut in prices of petrol and diesel might result in price reduction across the board. D&B therefore expects WPI inflation to average between 6.80-7.00% during Dec-08.

## Money & Finance

### RBI expected to cut policy rates further

In an attempt to stimulate demand and support the slowing economy, RBI signaled towards a lower interest rate regime by reducing the repo and reverse repo rate by 100 bps each effective 8-Dec-08. The RBI also announced other measures like liquidity support to the SIDBI, special dispensation for treating loans to HFCs as priority sector lending, etc to encourage flow of credit to SMEs and ailing sectors such as realty. While the cut in repo rate and reverse repo rate are expected to drive down the lending and deposit rates in the near future, other measures are likely to provide some relief to the SMEs, exporters, and the housing sector especially in the low cost segment.



Source: CCIL

The cut in repo and reverse repo rate provided some boost to the bond market and the benchmark 10-year bond yield fell to 6.68% on 8-Dec-08 as compared to 7.56% on 3-Nov-08. The yield on 15-91 day T-Bills eased to 6.5-7.2% as on 28-Nov-08 as compared to 6.5-7.6% as on 24-Oct-08. The call rates which remained in the range of 6.00-7.80% during the month of Nov-08 as compared to 17-17.5% (as on 31-Oct-08), indicated sufficient liquidity in the banking system. However, despite easy liquidity conditions and lowering PLR, the credit offtake from banks is showing signs of moderation primarily due to slackening demand and increased risk aversion on part of banks. The incremental credit offtake declined to Rs 176.59 bn between 25-Oct-08 to 21-Nov-08 as compared to Rs 725.74 bn between 26-Sep-08 and 24-Oct-08.

Going forward, given the accelerating pace of slowdown in the domestic economy, we believe that these monetary measures will have to be supplemented by further concrete steps in order to arrest the rapidly slowing growth momentum. D&B expects the RBI to cut policy rates further in the near future. D&B expects 15-91 day Treasury Bills yield to be in the range of 6.70%-6.90% during Dec-08.

## External Sector

### Global economic slowdown likely to hamper exports

With India's major trading partners entering into recession or witnessing a slowdown, the overseas demand for Indian goods has hampered significantly as is evident from the decline in exports by 12.1% (in Dollar terms) in Oct-08 as compared to an increase of 10.38% in Sep-08. Reflecting a slowdown in domestic demand, imports growth moderated to 10.57% during Oct-08 as compared to 43.33% in Sep-08 primarily due to a slowdown in growth of non-oil imports. With significant moderation in imports, the trade deficit narrowed marginally to US\$ 10.53 bn in Oct-08 as compared to US\$ 10.6 bn in Sep-08. In the wake of slowing demand and elevated credit risk to exporters coupled with non availability of finance, the RBI and the Government have taken a slew of measures to ensure an adequate flow of credit to the exporters. Measures such as interest rate subvention for labour intensive exports, back-up guarantee to be made available to ECGC so that exporters are not denied loans on the basis of risky destination markets, series of tax incentives and a refinance facility provided to the EXIM bank are expected to arrest decline in export growth. However, given the slacking demand in the overseas market, these measures are unlikely to boost exports to a great extent and it is most likely that India will miss its export target of US\$ 200 bn for FY09.



Source: Ministry of Commerce

In the forex market, the rupee witnessed high volatility during the month of Nov-08. The rupee, which appreciated by only 0.25% between 03-Nov-08 to 12-Dec-08, crossed 50 per US Dollar during the month. Though the decline in global crude oil prices and a moderation in the domestic inflation helped the rupee gain ground, factors like heavy losses endured in the domestic stock markets coupled with dollar demand from corporates and banks and oil importers weighed down the value of the rupee. D&B expects rupee to appreciate from the previous month's level and remain in the range of 48.50-48.80 to a US\$ during Dec-08.

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

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