



Decide with Confidence

Dun & Bradstreet

ECONOMY OBSERVER

Issue 9 | January 2008

Contents

[View from the top](#)

Page 1

[Real Economy](#)

[Price Scenario](#)

Page 2

[Money & Finance](#)

[External Sector](#)

Page 3

[View from the top](#)

As we had estimated in our December 2007 issue, growth in industrial production slowed down to 5% levels during Nov 07. IIP grew by 5.3% in Nov 07 as the high base effect of the previous year led to a moderation in growth. In addition to the high base, the impact of a tight monetary policy on consumer spending, continued to be reflected in industrial production numbers. A decline in consumer goods production pulled down growth in IIP by as much as 14.2% in Nov 07. The reduction in demand for consumer goods can also be attributed to the fact that most consumer purchases tend to take place just before the festive season. However, investment activity remained high as is reflected by the 24.5% growth in the capital goods sector, which in turn contributed 45% to the total growth in IIP.

On the price front, although prices of primary articles (both food as well as non food) and prices of manufactured products witnessed a slowdown in growth, fuel inflation rose to 2.19% in Dec 07 from 0.23% in the previous month. As a result, inflation rose to 3.53% during Dec 07 as compared with 3.26% in the previous month. Fuel price inflation will remain a concern in the months to come, given that domestic prices have not borne the full pass through of global oil prices which have touched US\$100 a barrel. At the same time, money supply at 22.8% (21-Dec-07), continues to grow above the RBI target range. Strong capital inflows, spurred by the increasing interest rate differential, have increased liquidity levels in the system. Given that an increase in interest rates will only exacerbate the surplus capital inflows situation, the RBI has limited options to deal with this scenario. Liquidity management through the use of the three main instruments - the MSS, the Cash Reserve Ratio and the Liquidity Adjustment Facility – will therefore remain at the forefront of the RBI's monetary policy. In order to curb excess liquidity from the system, the RBI may increase the Cash Reserve Ratio in the near future.

Given the high base of the previous year, slowing exports growth and continued high levels of interest rates, we expect IIP to grow between 6-7% in Dec 07, taking growth in IIP to 7.8-8% during Q3 FY08. With a slowdown in IIP growth, we expect growth in GDP to moderate further during Q3 FY08 as compared with Q2 FY08 .

Dun & Bradstreet's Economy Forecast

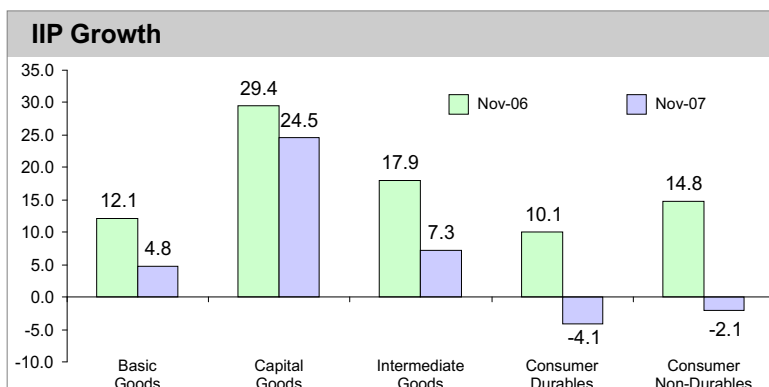
	FORECAST	ACTUALS	
		Latest Period	Previous Month
Inflation (W.P.I)	3.50-3.70%(Jan-08)	3.53%(Dec-07)	3.24%(Nov-07)
IIP Growth	6.00-7.00%(Dec-07)	5.30%(Nov-07)	12.00%(Oct-07)
15-91-day T-Bills	7.00-7.20%(Jan-08)	7.40%(Dec-07)	7.37%(Nov-07)
INR/US\$	39.20-39.40(Jan-08)	39.44(Dec-07)	39.44(Nov-07)

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

Real Economy

Consumer goods sector pulls down IIP growth by 14.2%

Industrial production, as measured by the Index of Industrial Production (IIP), grew at a lower rate of 5.3% (which is a 13-month low) during Nov 07; the high base of the year ago month played a significant role in moderating industrial growth. The manufacturing sector, which accounts for more than 80% of the total IIP basket, grew by 5.4% on top of a high growth of 17.2% during Nov 06. The impact of high interest rates on consumer spending continued to be reflected in industrial production numbers. Consumer goods production



Source: CSO

declined by 2.6% with consumer durables production declining by as much as 4.1%. Lower consumer goods production could be the result of a dip in demand since most consumer purchases take place just before the festive season. The consumer goods sector pulled down growth in IIP by as much as 14.2% in Nov 07. Food products, with a weight of about 9.1% in the index basket, pulled down growth in IIP by almost 27%.

However, the capital goods sector continued to grow at double digit rates of growth indicating a continued step-up in investment activity. The capital goods sector grew by 24.5% in Nov 07, contributing as much as 45% to the growth in IIP. Amongst the sectors, the Machinery & Other Equipment; Basic Chemicals & Chemical Products; Wood & Wood Products, Furniture & Fixtures accounted for more than 63% of total growth in IIP. Given the high base of Dec 06, slowing exports growth and continued elevated levels of interest rates, we expect growth in IIP to remain in the range of 6-7% in Dec 07.

Price Scenario

Fuel prices spur inflation

Although inflation, as measured by the Wholesale Price Index (WPI), inched up a little to 3.53% (y-o-y) during Dec 07 as compared to 3.26% (y-o-y) in the previous month; it is still within the RBI target of 4-4.5%.

Barring the fuel group, prices of major groups witnessed a moderation in growth. Prices of fuel group, which had remained almost unchanged in the previous month, registered a substantial growth of 2.19% (y-o-y) in Dec-07, which, in turn, put pressure on the overall inflation rate.

Items	Sep-07	Oct-07	Nov-07	Dec-07
WPI ALL	3.46	3.13	3.26	3.53
Primary Articles	6.41	4.92	4.68	4.41
Food Articles	4.51	2.93	2.91	2.84
Non Food Articles	12.99	11.74	10.78	9.41
Fuel	-2.47	-1.59	0.23	2.19
Manufactured Products	4.67	4.31	3.92	3.68

Source: Ministry of Commerce & Industry

Manufactured products, which accounted for more than 64% of overall inflation, witnessed a modest fall in inflation to 3.68% (y-o-y) in Dec-07 as compared to 3.9% (y-o-y) in the previous month. Within manufactured products, prices of textile products declined sharply registering a negative growth of 2.17% (y-o-y). The inflation rate of primary articles also continued to moderate and stood at 4.4% in Dec-07 as compared to 4.7% in the previous month. Amongst the food articles, prices of fruits and vegetables registered a negative growth of 2.8% (y-o-y) during Dec-07. Prices of non-food articles (which had been hovering above 10% since Jan-07) also moderated to 9.4% (y-o-y) during Dec-07 primarily due to the high base effect.

Given that international crude oil prices are high and domestic fuel prices are yet to bear the full pass through of international prices, we expect inflationary pressures on the fuel group to continue in the near future. In the wake of a possible upward revision in retail fuel prices during subsequent months, inflation could rise further.

We expect the WPI inflation to average at around 3.5-3.7% during the month of Jan 08.

Money & Finance

Money supply continues to grow at close to 23%

Although monetary tightening measures taken by the RBI have resulted in a moderation in credit offtake (to around 21.4% as of 28-Dec-07 from 30% levels witnessed during the previous year), money supply grew at 22.8%, much higher than the RBI target of 17.5%.

Strong foreign capital inflows driven by the widening interest rate differential between India & the US have continued to place upward pressure on money supply. In order to sterilise increasing foreign capital inflows, the RBI has once again resorted to conducting auctions under the Market Stabilisation Scheme. The auctions of 91 day and 182 days treasury bills that were held on

9-Jan-08 resulted in the absorption of Rs. 40 bn. Strong foreign fund flows and expectations of healthy domestic corporate earnings results also helped push the stock market to record highs and the Sensex crossed the 21,000 mark on 08-Jan-08. A surging domestic stock market and big IPOs scheduled for the current month are expected to attract more FII inflows, which, in turn, could further place upward pressure on money supply. Given that the RBI has limited options available to contain money supply, we expect a hike in the CRR in the near future. In the Government securities market, gilt yields declined following the Finance Minister's request to banks to reduce interest rates. The yield on the ten year benchmark gilt declined to a one year low of 7.65% on 9-Jan-08. 15-91 day Treasury bill yield were in the 7.2-7.5% range during the last week of December. We expect 15-91 day T-bills yield to be in the range of 7.0-7.2% in Jan 08.

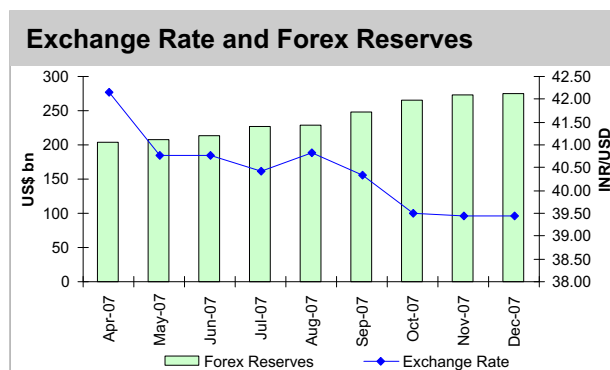
Monetary Indicators				
	FY07	Oct 07	Nov 07	Dec 07
M3*	21.3	22.5	22.8	22.8
Bank Credit*	28.0	22.5	23.3	21.4
Non Food Credit*	28.4	23.0	23.9	22.2
Prime Lending Rate (%) (Max.)	12.50	13.25	13.25	13.25
5 year G-secYield (%)	7.9	7.7	7.8	7.8%
Inflation (%)	5.4	3.1	3.3	3.5

*Figures are percentage Y-O-Y growth
All figures (excluding inflation) are as end of month
Source: RBI

External Sector

Trade deficit widens to US\$ 52.8 bn during Apr-Nov 07

The impact of the rupee's appreciation on export realisations is evident from the increasing divergence between exports growth in rupee terms and exports growth in dollar terms. Exports (in rupee terms) grew by 11.5% in Nov 07 as compared with almost 33% in the year ago month. Even in terms of dollars, exports grew by 26.8% compared with 35.2% in Nov 06. At the same time, imports (in dollar terms) grew by around 29%, driven by a 35.3% increase in non-oil imports. As a result, the trade deficit widened to US\$ 52.8 bn during Apr-Nov 07, as compared to US\$ 38.49 bn during Apr-Nov 06.



Source: RBI

However, despite a slowdown in exports growth and a widening trade deficit, the current account deficit for Q2 FY08 was lower at US\$ 5.5 bn (as compared with US\$ 6.3 bn in Q2 FY07) due to a high invisibles surplus. Net invisibles emanating from high NRI remittances, software and other professional service exports revenue amounted to US\$ 16.2 bn in Q2 FY08. Net portfolio investment at US\$ 10.9 bn during Q2 FY08 was the largest component of capital inflows.

Strong foreign capital inflows, in turn, have resulted in a sharp surge in foreign exchange reserves to US\$ 275.56 bn (as of December 28, 07), exerting further upward pressure on the rupee. The RBI's sustained intervention in the forex market did restrict the gains made by the rupee. Capital inflows are currently significantly higher than the current account deficit, the RBI may therefore have to take measures to control capital inflows.

Given that the rupee remains overvalued on a REER basis, we do not expect the rupee to appreciate substantially. We expect the rupee to remain in the range of 39.2-39.4 to a US\$ during the month of Jan 08.

Please send your feedback to Yashika Singh - Leader, 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