Decide with Confidence

Dun & Bradstreet
ECONOMY OBSERVER

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View from the top

Industrial production witnessed an upturn during Nov-08 and registered a growth of 2.38%. During Apr-Nov 08, growth in industrial production averaged at 3.9% as against 9.2% during Apr-Nov 07. The significant moderation in industrial production, decelerating growth of six core infrastructure industries and a decline in exports for the second consecutive month allude to the rapidly slowing pace of the Indian economy. Further, substantial moderation in advance tax collection indicates that profit margins of corporate sector might have come under pressure during the current fiscal. The central excise revenue collection too witnessed a decline of 1.5% during Apr-Nov 08, pointing towards slowdown in industrial activity.

Further, given a slowdown in the domestic manufacturing activity and recent decline in exports, employment scenario in the country is likely to be impacted. This will result in lower purchasing power in the hands of people, thus intensifying subdued demand conditions in the domestic economy. The Government and the RBI have already taken a slew of measures to boost domestic demand and arrest slowdown in economic activity. The cut in key policy rates by the RBI has induced banks to reduce lending rates. However, despite banks cutting lending rates, demand for retail credit and consumption demand might remain subdued in the short term as the purchasing power in the hands of people is likely to remain low on account of substantial moderation in the manufacturing activity and rising concerns of job-losses. In such a scenario, the significant moderation in the headline inflation is the only sliver lining. Given a sharp decline in global oil prices and the possibility of another round of cut in administered fuel prices, D&B expects inflationary pressures to ease further. D&B therefore expects further cut in repo and reverse repo rates by the RBI in the forthcoming monetary policy.

On external front, despite higher net invisibles surplus, the widening trade deficit primarily due to higher oil imports led to increase in current account deficit (CAD) during Q2 FY09. CAD for Q2 FY09 surged to US$ 12.5 bn (from US$ 4.3 bn during Q2 FY09), i.e. to 6.47% of GDP as compared with 2.21% of GDP during the year-ago quarter. However, when we consider the current account net of transfers, the deficit rises to as much as 13.82% of GDP. Given the slump in exports due to waning overseas demand, the surge in current account deficit might remain an area of concern in the coming quarters.

Dun & Bradstreet's Macro Economic Forecasts

		ACTUALS	
	FORECAST	Latest Period	Previous Month
Inflation (W.P.I)	4.70%-4.90%(Jan-09)	6.43%(Dec-08)	8.53%(Nov-08)
IIP Growth	2.50%-3.50%(Dec-08)	2.38%(Nov-08)	(-)0.34%(Oct-08)
15-91-day T-Bills	4.75%-5.00%(Jan-09)	5.22%(Dec-08)	6.87%(Nov-08)
INR/US$	48.30-48.60(Jan-09)	48.64(Dec-08)	49.00(Nov-08)

All figures are monthly averages

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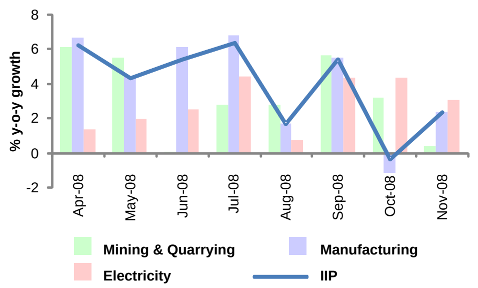
Real Economy

IIP growth rebounds

The Index of Industrial Production rebounded to some extent and registered a growth of 2.38%, during Nov 08, after experiencing a decline of 0.34% during Oct 08. However, growth in IIP during Nov-08 was lower as compared to 4.9% registered during Nov-07. Moreover, IIP growth has more than halved to average at 3.9% during Apr-Nov 08 as compared to 9.2% during Apr-Nov 07, indicating moderation in the growth momentum during the current fiscal. Further, growth in the Index of Six core industries, fell to 2.2% in Nov 08 compared to a growth of 5.1% in Nov 07 on account of a decline in the production of petroleum Refinery Products coupled with a slowdown in the production of electricity and coal.

Trends in IIP



Source: CSO

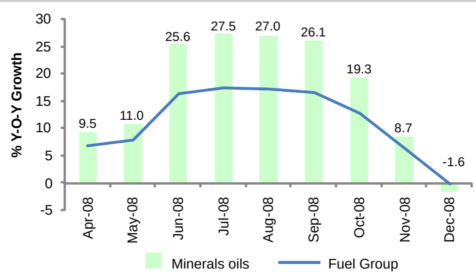
High interest rates, elevated raw material prices (during H1 FY09) coupled with waning demand has hampered the industrial activity significantly during course of the current financial year. While the decline in central excise revenue collection during the current fiscal corroborates the slowdown in industrial activity, the moderation in advance tax collection indicates, that companies are anticipating lower profits in the coming quarter. As per use-based classification, the growth in production of consumer non-durables of around 7.27%, contributed as much as 66% to growth in IIP. However, the consumer durables sector registered a decline of 4.15% in Nov 08 dragging growth in entire consumer goods sector to 4.42%. Slowdown in economic activity coupled with increasing reports of job losses and pay cuts might have hampered demand for consumer durables and thereby led to the decline in production. Besides, with rapid slowdown witnessed across sectors companies might postpone their capital expenditures thereby affecting the capital goods sector. Growth in capital goods production declined by 2.27% during Nov 08 indicating slowing investment demand. Moderating investment activity coupled with waning demand is likely to have a bearing on industrial production in short-term. D&B expects industrial production to have remained subdued and grown by 2.5-3.5% during Dec 08.

Price Scenario

Fuel group registers deflation during Dec-08

Significant decline in prices of minerals oil (such as aviation turbine fuel, light diesel oil, naphtha, bitumen, furnace oil and lubricants) and cut in the petrol and diesel prices by the Government (effective from 6-Dec-08) has led to deflation in minerals oil group. Prices of minerals oil declined by 1.60% (y-o-y) during Dec-08 as against growth of 8.66% during Nov-08. In fact, when we exclude the minerals oil category from the WPI basket, inflation during Dec-08 rises to 7.64% from 6.43%. With the decline in prices of minerals oil and a significant moderation in inflation of coal mining, prices for fuel group fell by 0.23% during Dec-08 as against growth of 6.44% during Nov-08. This in turn led the headline inflation to moderate further to 6.43% during Nov-08 as against 8.53% during Oct-08.

The WPI Inflation in Fuel Group

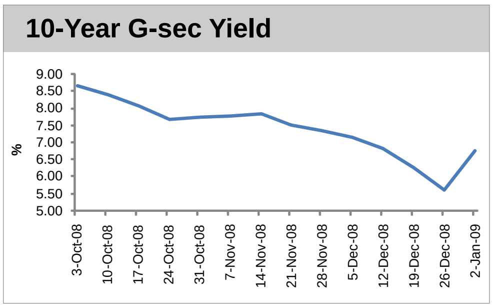


Source: Ministry of Commerce

Given the subdued demand conditions in the domestic and international markets, prices of manufactured products such as 'non-metallic mineral products', 'basic metal alloys & metal products' and 'transport equipment & parts' continued to moderate, resulting in sustained moderation in manufactured products inflation. Besides, given a decline in prices of oil cakes and a considerable moderation in prices of edible oils, inflation in manufactured food products declined to 3.74% during Dec-08, which is slightly higher than the same during Dec-07 (During Dec-07, inflation in manufactured food products stood at 3.41%). Further, inflation in manufactured food products is expected to fall further in the subsequent few months primarily due to low base effect and subdued demand conditions. Prices of primary food articles (particularly cereals and pulses) on the other hand, continued to surge, taking inflation in primary articles up to 11.91% during Dec-08. Nonetheless, the recent cut in petrol & diesel prices which are expected to result in lower transportation costs might ease inflationary pressures in agricultural and manufactured products. Besides, the possibility of another round of cut in administered fuel prices will result in further moderation in the headline inflation. D&B therefore expects WPI inflation to average between 4.70-4.90% during Jan-09.

Money & Finance

RBI expected to cut policy rates further



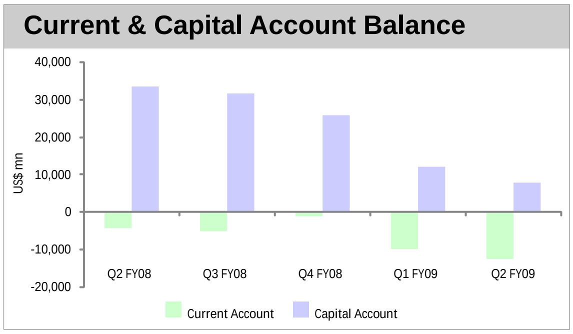
Source: RBI

With increasing evidence of slowdown in economic activity and rapidly moderating inflation, the RBI eased its monetary stance further to provide impetus to the economy. The RBI decided to cut CRR by 50 basis points (effective 17-Jan-09) and the repo and reverse repo rate by 100 basis points each w.e.f 2-Jan-09. While the repo rate cut is likely to induce banks to cut their lending rates, the reduction in reverse repo rate might discourage banks from parking excess fund in the reverse repo facility and thereby increase lending to the productive sectors. With significant easing of RBI's monetary stance many banks have already began to reduce their lending rates leading the PLR to decline to 12.50-13.25% in Dec 08 from 13.00-13.50% during Nov 08. Moreover, given the sufficient liquidity in the banking system the weighted average call rates have eased to 4.2% (on 13-Jan-09) as compared to 6.61% (on 28-Nov-08).

Despite easy liquidity conditions and lowering PLR, the credit offtake from banks is showing signs of moderation. Growth in Bank credit moderated to 23.1% (y-o-y) as on 26-Dec-08 as compared to 27% as on 21-Nov-08. Lower credit offtake could in part be attributed to slackening demand conditions and increased risk aversion on part of banks due to rapidly slowing economic activity. Further, the cut in policy rates by the RBI boosted sentiments in the G-sec market, leading the yield on the 10-year benchmark gilt to drop to 5.07% (closing yield) on 02-Jan-09, down by 169 basis points as compared to 05-Dec-08. The 15-91 days T-bill yield moderated to 4.4-5.2% for week ended 2-Jan-09 as compared to 5.7-7.4% for week ended 5-Dec-08. Although the recent cut in policy rates is likely to help the corporate sector to some extent, given the subdued domestic demand conditions and waning exports the economy is unlikely to reverse in the short run. D&B expects RBI to cut interest rates further in the forthcoming monetary policy review to stimulate demand and boost confidence in the economy. D&B expects 15-91 day Treasury Bills yield to be in the range of 4.75-5.00% during Jan-09.

External Sector

Exports record a decline for the second consecutive month



Source: RBI

Exports registered a decline of 9.9% (in dollar terms) for the second straight month in Nov 08 after contracting by 12.1% in Oct 08, a reflection that the global economic slowdown is increasingly weighing on the demand for India's goods. Weakening exports and domestic demand is likely to put further pressure on industrial growth which might impact employment scenario to a certain extent. In fact, a sample study by the Department of Commerce for 121 export related companies for the period Aug-Oct 08 has indicated fall in jobs due to a slowdown in some export sectors. Significant moderation in imports, which grew by 6.1% in Nov 08 as compared to a growth of 10.6% during Oct 08, also reflected subdued domestic demand conditions. However, with imports posting a significant lower growth, trade deficit has improved marginally to US$ 10.0 mn in Nov 08 as compared to US$ 10.5 mn during Oct 08. Nevertheless, widening of the trade deficit during Q2 FY09 has led to higher deficits in the current account balance, despite net invisibles recording a surplus. During Q2 FY09 current account posted a deficit of US$ 12.5 bn as compared to US$ 4.3 bn during Q2 FY08. On the other hand, surpluses in the capital account, which had offset the current account deficit during the earlier quarters had moderated significantly during Q2 FY09 leading to a deficit in the BoP. BoP noted a deficit of US$ 4.7 bn for the first time in three years. Moderation in FDI, short-term trade credits and net outflows in the portfolio investment due to large sales of equities by FIIs and slowdown in net inflows under ADRs/GDRs due to drying-up of liquidity in the overseas market had largely impacted net capital inflows under capital account.

In the forex market, rupee experienced an appreciation from the previous month's level, following a bullish trend in the domestic stock market and a decline in global crude oil prices. D&B expects the rupee to appreciate further and remain in the range of 48.30-48.60 to a US$ during Jan 09.

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