



Decide with Confidence

Dun & Bradstreet

ECONOMY OBSERVER

Issue 14 | June 2008

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With inflation crossing 8%, price control is likely to be the over-riding concern for policy makers over the next few months. Inflation, as measured by the WPI, stood at 8.75% (for the week ended 31-May-08), spurred by high primary articles prices. Prices of Primary Articles have been contributing more than 24% to the increase in WPI inflation over the last few weeks. The CPI, which allocates a higher weight to food items, increased by as much as 7.8% during the month of Apr 08. Given that food prices have risen further during the last month, the figure for CPI inflation is likely to be even higher during May 08 and Jun 08. With prices of the Indian basket of crude oil crossing US\$ 130 bn, the Government decided to increase domestic retail prices of petrol, diesel and LPG. Concomitantly, it has lowered customs duties and excise duties on petroleum products and decided to continue issuing oil bonds. The cuts in excise and customs duties on petroleum products are expected to result in a revenue loss of Rs 220 bn to the Government. At the same time, the increased issuance of oil bonds will also add to the Government's fiscal costs. We will see the impact of the hike in domestic fuel prices during the next few weeks since this hike is effective 04-Jun-08. We estimate the direct impact of the hike in domestic fuel prices will be a 0.5 percentage point increase in WPI inflation. Additionally, with higher fuel costs, fertiliser prices and transportation costs are likely to increase, in turn resulting in a rise in prices of several commodities, both food as well as non food.

On the monetary front, money supply (M3) and credit offtake continue to grow above the RBI's target rate despite successive hikes in the Cash Reserve Ratio during Apr 08 and May 08. With rising prices, high money supply and increasing inflation expectations, the RBI decided to hike the repo rate by 25 basis points to 8%. While this measure will help in containing inflation expectations, it is unlikely to have a direct impact on curbing inflation in the short-term given that the current inflation being witnessed in the economy is being driven by supply side constraints in both the domestic and international markets. On the other hand, banks are likely to raise their short-term lending rates since their costs of borrowing will now be higher. Higher lending rates, in turn, are likely to impact credit offtake and growth. We therefore expect industrial production to remain subdued over the next few months. Further, we expect the RBI will resort to another hike in its key policy rates in the near future in order to contain inflation expectations.

Dun & Bradstreet's Macro Economic Forecasts

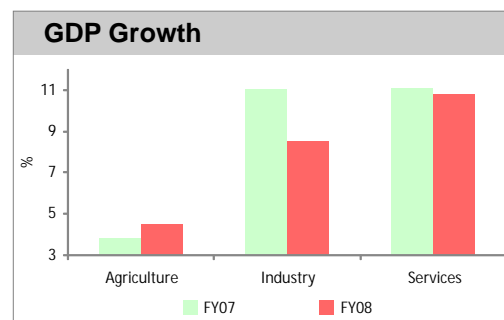
	FORECAST	ACTUALS	
		Latest Period	Previous Month
Inflation (W.P.I)	9.0%-9.2%(Jun-08)	8.27%(May-08)	7.41%(Apr-08)
IIP Growth	7.0%-8.0%(May-08)	7.02%(Apr-08)	3.94%(Mar-08)
15-91-day T-Bills	7.2%-7.4%(Jun-08)	6.84%(May-08)	6.60%(Apr-08)
INR/US\$	42.80-43.00(Jun-08)	42.13(May-08)	40.03(Apr-08)

All figures are monthly averages

Real Economy

GDP growth revised upwards to 9%

Economic growth for FY08 was revised upwards to 9% from 8.7%, above the market consensus. The increase of 0.3 percentage points to the GDP growth estimate is primarily on account of revisions in estimates for agricultural crops production during FY08; the agricultural sector is estimated to have grown by a healthy 4.5% during FY08. However, growth in the industry (8.5%) and services (10.8%) sectors remained lower as compared with the previous year as high interest rates and an appreciating rupee took a toll on demand. The slowdown in growth was however most pronounced in the manufacturing sector, especially during Q4 FY08, when manufacturing grew by a mere 5.8% as compared with 12.8% during the same period last fiscal. Data on the Index of Industrial Production further corroborates the impact of high interest rates on demand conditions. IIP grew by 6.4% (on an average) during the first four months of 2008 as compared with 12% during the same period last year. IIP grew by 7% during Apr 08 as compared to 11.3% during Apr 07. The basic goods sector and the intermediate goods sector, which together, hold a 60% weight in the index accounted for just 40% of the growth in IIP during Apr 08. However, the capital goods sector, which has a weight of less than 10% contributed more than 20% to IIP growth. Although interest rates remain high, prospects of robust growth and a wide market base has propelled some companies to enhance capacities.



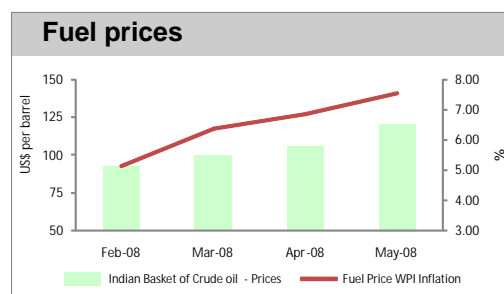
Source: CSO

However, the recent hike in the repo rate is likely to result in an increase in the cost of capital for companies, thereby adversely affecting growth. Given the possible implications of the recent hike in the repo rate, high inflation and a global growth slowdown, we expect industrial production to remain subdued during the months to come. We expect IIP to grow between 7-8% during May 08.

Price Scenario

Direct impact of hike in fuel prices to result in a 0.5 percentage point increase in WPI inflation

With prices of the Indian basket of crude breaching the US\$ 130 per barrel mark during Jun 08, the Government decided to increase retail prices of petrol, diesel and LPG by Rs 5, Rs 3 and Rs 50 respectively, effective 04-June-08. We expect the direct impact of the hike in domestic fuel prices to be a 0.5 percentage point increase in WPI inflation. Further, the fuel price hike will also result in an increase in input costs and transportation costs for the agricultural and industrial sectors.



Source: Ministry of Petroleum & Natural Gas; Ministry of Commerce

Prices of industrial fuels such as naphtha and bitumen, (which are not subsidised) have also soared. The price of aviation turbine fuel, in particular, has increased by almost 60% during May 08, thereby placing upward pressure on airfare prices. This, however, is not reflected in the WPI inflation rate, since this index does not take services prices into account. With the surge in industrial fuel prices, fuel group inflation stood at 7.71% in May 08 as compared with 6.85% in Apr 08. In the manufacturing group, prices of basic metals alloys & metal products and food products contributed around 35% to the increase in WPI inflation. Inflation in edible oil, however has shown some moderation; edible oil prices grew by 12.16% in May 08 as compared with 14.89% in the previous month. This is possibly due to a reduction in customs duties on edible oil, announced by the Government. Primary articles prices continued to contribute more than 24% to WPI inflation, spurred by high iron ore prices and high cereal prices. As a result, WPI inflation averaged at 8.27% during May 08 and touched as much as 8.75% during the week ended 31-May-08 for the first time in 7 years.

With mounting inflationary pressures, the RBI resorted to a 25 basis points hike in the repo rate. While this measure will help in containing inflation expectations, its direct impact on curbing inflation is likely to be limited in the short run given that the current rise in prices is being driven by supply constraints in both domestic and international markets. Given the existing supply constraints and the hike in fuel prices, we expect WPI inflation to average at between 9.0-9.2% during Jun 08.

Money & Finance

Short-term interest rates to increase

With money supply and bank credit growing at rates far above the RBI's target and with inflation crossing the 8% mark, the RBI resorted to a 25 basis points hike in the repo rate to 8.00%. Given that such a measure implies an increase in banks' borrowing costs, we expect lending rates, in particular, short-term lending rates to go up in the near future. This, in turn, is likely to impact credit growth and hence money supply. Money supply continues to grow at 22.5%, (during the week ended 23-May-08) well above the RBI target rate of 16.5-17%, despite the hike in the Cash Reserve Ratio.

Monetary Indicators				
	FY07	FY08	Apr-08	May-08
M3*	21.3	20.7	21.2 [#]	22.5 [*]
Bank Credit*	28	21.6 [§]	23.4 [#]	25.5 [*]
Non food Credit*	28.4	22.3 [§]	24.5 [#]	25.6 [*]
Prime lending rate (%) (Min-Max.)	10.25-12.5	12.25-12.75	12.25-12.75	12.25-12.75
Inflation (%)	5.4	4.51	7.41	8.27

*Figures are percentage Y-O-Y growth
§ As on 28-Mar-2008; ^ As on 23-May-2008; # As on 25-Apr-2008
Source: RBI

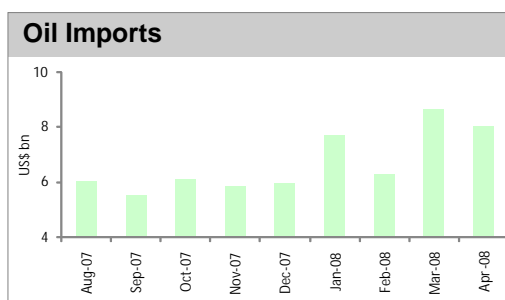
Bank credit has also grown by 25.5% during the month of May (as on 23-May-08), spurred by a 25.6% increase in non-food credit and a 21.13% growth in food credit. The increase in food credit could perhaps be attributed to enhanced food grains procurement efforts taken by the Government in order to tackle supply constraints that have placed upward pressure on food prices during the last few months.

In the interbank money market, liquidity conditions tightened, especially during the last week of May 08, resulting in a firming up of call rates to 7-7.25% (as on 30-May-08). Yields in the G-sec market also rose amidst mounting inflationary pressures backed by a hike in domestic fuel prices and speculation surrounding a possible hike in key policy rates. The yield on the ten-year benchmark gilt rose to a 22 month high of 8.28% as on 09-Jun-08. 15-91 days Treasury bill yields were in the range of 5.6-7.6% during the week ended 23-May-08. Given the tightening of monetary conditions, we expect short-term interest rates to increase. We therefore expect 15-91 days Treasury bill yields to remain in the 7.2-7.4% range during Jun 08.

External Sector

Trade deficit widens as oil import bills rise

Surging international oil prices led to a sharp increase in oil import bills during Apr 08. In fact oil-imports increased by almost 46.2% to US\$ 8.02 bn in Apr 08, taking total growth in imports to 36.6%. Although exports also registered an impressive growth of 31.5% (y-o-y) in dollar terms, it was lower than imports leading to a widening of the trade deficit to US\$ 9.87 bn during Apr 08. In rupee terms as well, exports grew by 24.8% (y-o-y) in Apr 08 as compared to 16.04% in Mar 08, indicating the positive impact of the depreciation in the rupee's value against the US Dollar.



Source: Ministry of Commerce

The rupee weakened in dollar terms and depreciated and crossed the 43 per US Dollar mark (intra day) during the month of May primarily on account of oil importer led dollar demand. FII outflows from the equities markets may have also placed some downward pressure on the value of the rupee. FIIs were net sellers in equities to the tune of US\$ 1.2 bn (2-May-2008 to 30-May-2008). However, RBI intervention in the forex market through dollar sales helped the rupee to appreciate to some extent.

Further, with the relaxation in overseas borrowing norms for corporate (External Commercial Borrowings) accompanied with a possible firming up of domestic interest rates, the corporate sector may resort to borrowings from international markets at lower rates on a larger scale. In such a situation, dollar inflows may increase.

However, in the current scenario of surging energy prices, the slowdown in foreign fund inflows, and high inflation, we expect the rupee to be in range of 42.8-43.0 during June 08.