Dun & Bradstreet
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Decide with Confidence

Contents

View from the top

India's GDP growth slowed to 8.4% during Q3 FY08, almost in line with D&B estimates (8.5%). Industrial production (IIP) growth at 5.3% for the month of Jan 08 also points toward a growth slowdown. The moderation in consumption is increasingly evident from the sustained decline in the contribution of consumption expenditure to GDP, a slowdown in growth of consumer durables production and slowing bank credit growth. Although a cut in key interest rates would seem a likely solution and would boost consumption levels, given the current scenario of high inflationary expectations, it is unlikely that the RBI would do so in the near future. It remains a possibility, however, during the second half of 2008. Budget measures such as the hike in the income tax exemption limit and tax slabs may aid in boosting consumption.

On the public finances front, although the fiscal deficit for FY08 at 3.1% of GDP is lower than the target rate of 3.3%, this figure does not include oil subsidies. Going forward, the implementation of the Sixth Pay Commission's recommendations will also add to the Government's fiscal costs.

Inflation is likely to remain a key concern during the next few months. The Wholesale Price Index crossed 5% (WPI stood at 5.02% during the week ended 23-Feb-08) after more than eight months, spurred by an increase in prices of primary articles and fuel. Supply side constraints have pushed primary articles inflation, to an average of 5.26% during Feb 08 (up until 23-Feb-08). Given that the production of rabi crops is expected to be lower than last year's production level, domestic inflationary pressures on some food articles will persist. Further, a cut in customs duty on commodities will have a limited impact since international commodity prices remain high. Domestic fuel prices have not yet borne the complete pass through of international prices. The Indian basket of crude oil has already touched the US$ 100 per barrel mark.

Another emerging concern is that of the trade deficit, which touched a record high of US$ 9.36 bn in Jan 08 on account of a spurt in imports. With rising crude oil prices and slowing exports, the trade deficit is likely to widen further. Moreover, with a possible slowdown in services exports, we expect that the current account deficit will expand.

Dun & Bradstreet's Macro Economic Forecasts

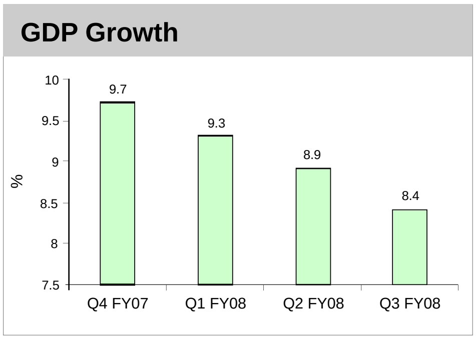
		ACTUALS	
	FORECAST	Latest Period	Previous Month
Inflation (W.P.I)	5.00%-5.20%(Mar-08)	4.76*%(Feb-08)	3.95%(Jan-08)
IIP Growth	6.00%-7.00%(Feb-08)	5.35%(Jan-08)	7.70%(Dec-07)
15-91-day T-Bills	7.00%-7.20%(Mar-08)	6.85%(Feb-08)	6.74%(Jan-08)
INR/US$	40.30-40.50(Mar-08)	39.73(Feb-08)	39.37(Jan-08)

** Data up to 23rd Feb 2008*
All figures are monthly average

Real Economy

Contribution of capital goods to IIP growth at 69 month low

High interest rates and an appreciating rupee which led to a considerable moderation in demand, pulled down India's GDP growth for Q3 FY08 to 8.4% as compared with 9.1% in the year ago quarter. The moderation in agricultural sector growth to 3.2% could be largely attributed to a slowdown in growth of rice and cotton output during the Kharif season of FY08 and a negative growth registered by sugarcane output. Amongst the services, the finance, insurance, real estate & business services sector witnessed a considerable moderation in growth to 11.6% in Q3 FY08 (as against 14.7% in Q3 FY07).



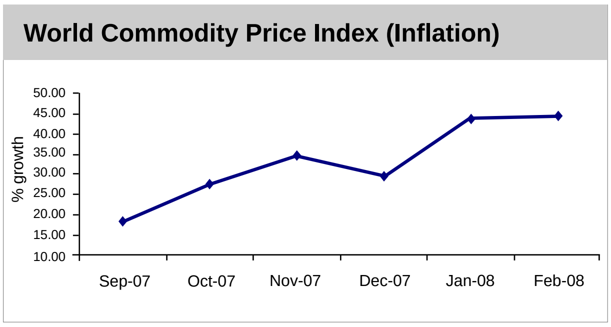
Source: CSO

The slowdown in growth was however most pronounced in the manufacturing and construction sectors which grew by 9.3% and 8.4%, respectively. As a result, the industrial sector grew by just 8.4% during Q3 FY08 as compared with 10.4% during Q3 FY07. IIP data for Jan 08 points to a likely continued slowdown in industrial sector growth during the current quarter (Jan-Mar 08) as well. Almost ten out of the seventeen manufacturing industry groups, accounting for a weightage of around 47% in IIP, witnessed decelerated/ negative growth during Apr-Jan FY08. As per used based classification, capital goods sector production grew by just 2.1% during Jan 08 as compared with 16.6% in the previous month reflecting the impact of high interest rates on investment. The capital goods sector contributed just 3.9% to the overall increase in IIP, which is the lowest contribution by this sector in the last 69 months. Growth in the consumer goods sector continued to slow down in Jan 08 with consumer durables registering a negative growth of 3.1%. Although the consumer goods sector is likely to continue to be impacted by high interest rates in the near future, budget measures such as a reduction in indirect taxes coupled with an increase in the income tax exemption limit and tax slabs may spur domestic consumption demand to some extent. We expect the Index of Industrial Production to recover slightly and remain in the 6-7% range during Feb 08.

Price Scenario

WPI crosses 5%; Supply side constraints persist

Inflation continued its march northwards, crossing the RBI threshold limit of 5%, for the first time in more than eight months. WPI inflation stood at 5.02% during the week ended 23-Feb-08, up from 4.89% during the previous week. During the first three weeks of Feb 08, inflation has averaged at 4.75%, spurred by a rise in prices of primary articles and fuels. With an upward revision in domestic retail prices of petrol and diesel, the contribution of the fuel group to overall inflation increased from 13.8% in Jan 08 to 15.5% in Feb 08 (for the three weeks ended 23-Feb-08). Primary articles inflation, which had witnessed some moderation during the last six months, firmed up to average at 5.26% during Feb 08 (three weeks ended 23-Feb-08). This group's contribution to overall inflation has increased from 22% in the previous month to 24.6% in Feb 08. Supply side constraints have placed inflationary pressures on several commodities, including wheat and rice. Within the manufacturing group too, high edible oil and oil cake prices pushed inflation in the food products group to 6.55%.



Source: IMF

Going forward, we expect inflation to remain a concern in the near future. The production of rabi crops is expected to decline by 3.3 mn tonnes during FY08. As a result, inflationary pressures on food articles will remain. Short-term measures taken by the Government such as the cut in customs duty on edible oils will have a limited impact, given that supply side constraints in global markets have kept international prices high. The World Commodity Price Index increased by as much as 44% in Feb 08. High international commodity prices are likely to have a bearing on domestic prices. Further, the Indian basket of crude oil has touched the US$ 100 per barrel mark and domestic retail fuel prices have not yet borne the complete pass-through of international prices. We expect WPI inflation to average at around 5.0 -5.2% during the month of Mar 08.

Money & Finance

Sensex drops by 901 points in a single day

Growth in bank credit has slowed from 30% levels witnessed at the beginning of this fiscal to the current level of 21.8% (as of 15-Feb-08), despite the presence of high liquidity in the banking system. With a moderation in the contribution of consumption expenditure to GDP growth and the widening India-US interest rate differential, a cut in the RBI's key interest rates would seem a likely outcome to boost consumption. However, given the current scenario of rising inflationary expectations, we do not expect a cut in the RBI's key interest rates in the immediate future. It remains a possibility during the second half of 2008.

Monetary Indicators

	FY07	Dec-07	Jan-08	Feb-08
M3*	21.3	22.8#	23.8$	21.5^
Bank Credit*	28	22.2#	22.5$	21.8^
Non food Credit*	28.4	22.9#	23.1$	22.4^
Prime lending rate (%) (Min-Max.)	10.25-12.5	12.75-13.25	12.75-13.25	12.50-13.25
5 year G-sec yield (%)	7.9	7.8#	7.5$	7.6
Inflation (%)	5.4	3.5	4.0	4.8

**Figures are percentage Y-O-Y growth; $ As on Jan 18, 2008*
 # As on Dec 21, 2007; ^As on Feb 15, 2008
Source: RBI

In other words, we believe that interest rates have reached their peak. A few PSU banks have already announced a cut in their Prime Lending Rates so as to enhance credit offtake, particularly in the retail segment. A decline in PLR rates and fiscal measures announced in the Budget such as the increase in tax exemption limits and a cut in CENVAT and excise duties are expected to enhance consumer demand. However, the announcement of these measures failed to buoy sentiment in the domestic stock markets. On the subsequent trading day, the BSE Sensex declined by 901 points (on 3-Mar-08), with the Banking Sector Index, in particular, declining by as much as 6.7% due to the lack of clarity (at the time) of the impact of the farmer's debt waiver package on the banking sector. FII's were net sellers in equities to the tune of Rs 6.84 bn on 3-Mar-08.

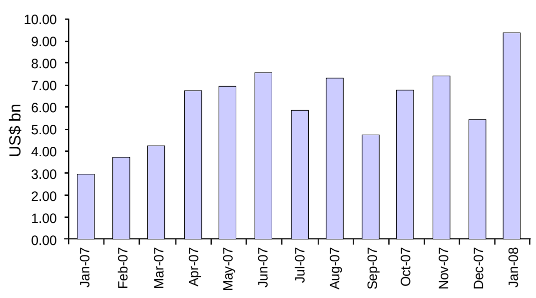
The yield on the 10 year G-Sec, which had risen to 7.69% on 26-Feb-08, eased to 7.56% on 29-Feb-08, following the announcement of a lower than expected fiscal deficit for FY08 and a smaller Government borrowing target for FY09. 15-91 day Treasury bill yields remained in the range 6.5-7.5% during the month of Feb 2008. We expect 15-91 day T-bills yield to be in the range of 7.0-7.2% in Mar 08.

External Sector

Trade deficit at record high; Rupee returns to 40 per dollar levels

An increase in crude oil imports by oil PSUs coupled with an increased demand for non-oil imports spurred India's imports in Jan 08 to an all-time high of 63.57% (in dollar terms). Even in terms of rupees, imports grew by 45.3% in Jan 08. The remarkable growth witnessed in imports can also be attributed, in part, to the low base of the previous year. The impact of the rupee's appreciation on trade continued to be reflected in the divergence between export realisations in dollar terms and in rupee terms. Although, exports in dollar terms, grew by 20.47% (y-o-y) in Jan 08, in rupee terms, export grew by just 6.97% as compared with 19% recorded during Jan 07. As a result, the trade deficit for Jan 08 widened to touch a record high of US$ 9.36 bn in Jan 08. This figure represents as much as 14% of the trade deficit for the entire Apr 07-Jan 08 period, and is almost three times higher than the deficit of US$ 2.85 bn recorded Jan 07. Given the slowdown in exports growth and with global crude oil prices surging past the US$ 100 mark, we expect the trade deficit to widen further. Moreover, given a possible slow down in the growth of services exports, a higher trade deficit could result in a widening of the current account deficit.

India's Trade Deficit



Source: Ministry of Commerce

With the sharp rise in global oil prices, there has been an increase in oil importer-led dollar demand, resulting in a fall in the value of the rupee during Feb 08. The rupee is now back to 40 per dollar levels, a value last seen in Sep 07. We expect the rupee to remain in the range of 40.30-40.50 to a US$ during the month of Mar 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