



Decide with Confidence

Dun & Bradstreet

ECONOMY OBSERVER

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The negative IIP growth in Jan 09 (for the second consecutive month) reiterates the slowing pace of the Indian economy. Significant fall in the demand have hampered industrial production during the last few months. The IIP data reveals that sectors such as 'food products', 'textiles', 'wood & wood products', 'leather, leather & fur products', 'rubber, plastic, petroleum & coal products' (with a weight of over 30% in the manufacturing sector index) witnessed an average negative growth during Apr-Jan 09. Since many of these sectors are labour-intensive in nature, the decline in production is expected to adversely impact employment within these sectors. The combined effect of slowing industrial production growth and falling exports will be felt in growth prospects of the Indian economy.

The impact of the various measures taken by the Government as well as the RBI since Oct 08 will unfold over time. Given the absence of any growth stimulating measures in the interim budget, plus the possibility of announcement of additional fiscal measures shifting to post-May 09, when the new Government comes into place, we expect the RBI to announce further monetary measures to boost domestic demand conditions. While these measures are likely to provide support to domestic demand, export growth would continue to remain in the negative territory in the near future.

On the inflation front, the headline inflation continued to moderate and touched one-year low of 3.18% during Feb-09. Moreover, with falling fuel group inflation, strong base effect and the benefits of excise duty cuts available beyond 31-Mar-09, the WPI inflation is expected to recede faster in the coming weeks and the economy may witness deflation in early Apr 09 - ahead of our initial expectations of early May 09. However, the consumer price inflation, which is more representative of a household consumption basket, continues to remain at elevated levels. The consumer price inflation for Industrial Workers was at a 10-year high of 10.45% in Jan 09. Given that the growth in agriculture production is projected to be low in FY09, prices of food grains will be under pressure in the near future. In the current scenario of growing economic uncertainty and rising job-losses, higher prices of food grains is likely to be an added concern.

Dun & Bradstreet's Macro Economic Forecasts

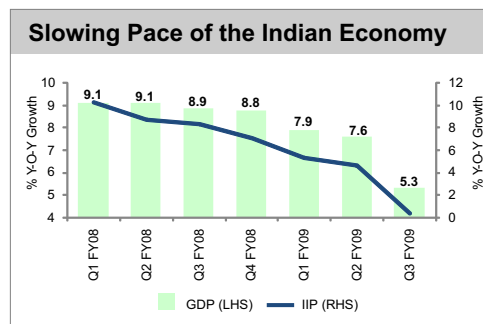
	FORECAST	ACTUALS	
		Latest Period	Previous Month
Inflation (W.P.I)	0.90%-1.10%(Mar-09)	3.18%(Feb-09)	5.17%(Jan-09)
IIP Growth	0.50%-1.00%(Feb-09)	-0.53%(Jan-09)	-0.63%(Dec-08)
15-91-day T-Bills	4.40%-4.70%(Mar-09)	4.63%(Feb-09)	4.52%(Jan-09)
INR/US\$	51.20-51.50(Mar-09)	49.22(Feb-09)	48.83(Jan-09)

All figures are monthly averages

Real Economy

IIP contracts for the second month in a row

GDP growth during Q3 FY09 slipped to 5.3%, primarily due to an unexpected decline of 2.2% in the agriculture sector. Barring the decline in the agriculture sector that was contrary to our expectation of around 2.5% growth in Q3 FY09, growth in other sectors was in line with D&B's expectation. The significant moderation in industrial growth to 2.4% in Q3 FY09 from 6.1% in Q2 FY09 mirrors the slowdown in domestic and global demand. The higher growth of 9.9% recorded by the services sector during Q3 FY09 (9.6% in Q2 FY09) is largely on account of a 17.3% growth in the 'community, social and personal services' sub-sector. Increased Government spending is likely to have driven the growth in this sub-sector.



Source: CSO

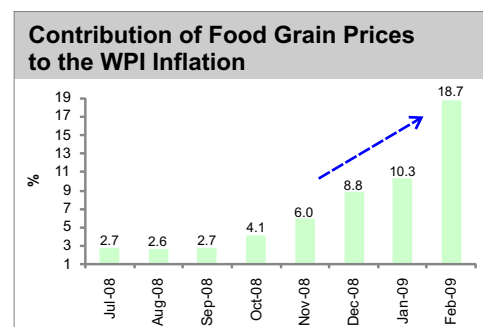
The index of industrial production contracted by 0.5% in Jan 09 - for the second month in a row- taking the cumulative IIP growth during Apr-Jan 09 to 3% as against 8.8% in the year-ago period. While the IIP growth during the past two months has been in the negative territory, the revision in Dec 08 IIP growth numbers to -0.6% from the initial estimate of -2% does provide a glimmer of hope. The capital goods sector grew by 15.4% in Jan 09, partly attributable to the low base of the year-ago period. Going forward, owing to the large unexecuted order book position of leading engineering and capital goods companies, the capital goods sector is likely to remain resilient. After contracting for three consecutive months since Oct 08, the consumer durables sector grew by 2.5% in Jan 09. The benefits of excise duty cuts available beyond 31-Mar-09 and cut in lending rates could provide some more fillip to the consumer durables sector.

The impact of the various measures taken by the Government as well as the RBI since Oct 08 would begin to unfold gradually and provide some support to the weakening economy. Going forward, we do not expect any further decline in the manufacturing as well as agriculture sector and hence we believe that the GDP growth would be around 6.2-6.3% in Q4 FY09. We expect IIP growth to remain subdued till the first quarter of FY10 and to have grown within the 0.5-1.0% range during Feb-09.

Price Scenario

Food grain prices continue to surge

With a significant moderation in global commodity prices, inflationary pressures in the economy have eased considerably. Inflation as measured by the WPI, moderated to 2.43% (y-o-y) for the week ended 28-Feb-09, taking the average inflation for the month of Feb-09 to 3.18% as against 5.17% in Jan-09. The substantial moderation in the headline inflation can largely be attributed to a sharp decline in prices of fuel group which pulled down the headline inflation by almost 15% during Feb-09.



Source: Ministry of Commerce

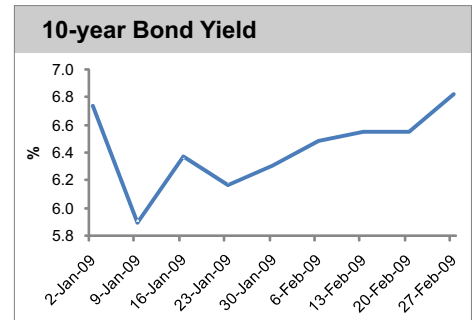
With the slowdown in domestic and external demand, prices of iron & steel began to moderate since Nov-08. This coupled with a decline in prices of aluminium & other non-ferrous metals caused inflation in 'basic metals alloys & metal products' to decline to 2.36% during Feb-09 from 8.91% during Jan-09. Inflation in manufactured food products on the other hand inched up to 7.18% during Feb-09, contributing as much as 26% to the headline inflation. The increase in manufactured food products inflation was largely driven by the soaring prices of 'sugar, khandsari & gur' which contributed almost 88% to the manufactured food products inflation. Inflation in manufactured products averaged at 4.52% during Feb-09 as against 5.73% during Jan-09.

Inflation in primary articles though receded from the double digit level (6.77% during Feb-09), prices of food articles particularly food grains (both cereals & pulses) remained elevated. Prices of food grains increased by 11.88% during Feb-09 and contributed 18.7% to the headline inflation. Further, given that the growth in agriculture production is projected to be low in FY09 on account of the expected fall in kharif as well as rabi crop production, prices of food grains might continue to remain high in the near future. Nonetheless, with falling fuel group inflation, strong base effect and the benefits of excise duty cuts available beyond 31-Mar-09, the WPI inflation is expected to recede faster in the coming weeks and the economy may witness deflation in early Apr 09 - ahead of our initial expectations of early May 09. D&B expects WPI inflation to average between 0.90%-1.10% during Mar-09.

Money & Finance

Bond yields likely to remain elevated

In view of slowing pace of the Indian economy and rapidly moderating inflation, the RBI eased its monetary stance further; cutting the repo and reverse repo rates by 50 bps each to 5% and 3.5% respectively (w.e.f. 4-Mar-09). The cut in key policy rates was mainly aimed at encouraging banks to lower their holdings with the RBI and thereby increase lending. Nonetheless, given that some term-deposits are locked in at a much higher rate, the reduction in key policy rates might translate into lower lending rates with some time lag. However, in the wake of high fiscal deficit and the possibility that the additional fiscal measures might be announced only after the new Government is in place, the RBI is expected to announce further monetary measures to boost domestic demand conditions.



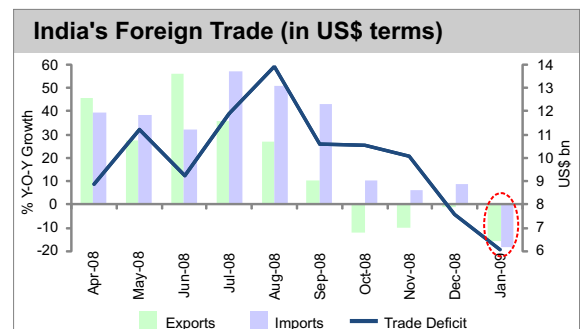
All figures stand for week ended data
Source: RBI

Despite the cut in key policy rates and comfortable liquidity conditions, the yield on the ten-year benchmark gilt surged during Feb-09 and touched 7% as on 12-Mar-09. The hardening of bond yields can largely be attributed to the enhanced borrowing programme of the central Government. With the increased Government borrowing, the huge supply of bonds that is scheduled for the current fiscal year might lead bond yields to remain elevated in the near future. 15-91 day Treasury bill yield too remained high during Feb-09 and hovered in the range of 4.25%-4.75% for the week ended 27-Feb-09. Furthermore, the yield on corporate bonds moved upward consequent to an increase in supply of fresh Government bonds that lowered investor appetite for corporate bonds. On the other hand, despite huge outflow of liquidity on bond auctions, liquidity conditions remained comfortable, leading to softening of call rates to 3.77% (as on 13-Mar-09). However, in the coming weeks the market might witness temporary liquidity pressures owing to advance tax payments. D&B expects 15-91 day T-Bills yields to average at around 4.40%-4.70% in Mar-09.

External Sector

Exports to remain grim for a major part of CY09

Exports suffered their biggest decline in a decade, plunging by 15.9% (in US\$ terms) in Jan-09 - the fourth successive month to clock a negative growth. Shrinking world demand has affected India's key exports sectors namely Handicrafts, Gems & Jewellery, Leather and Textiles. Gems & Jewellery exports have been on a decline since Nov 08 and in Feb-09, exports contracted by 34.6% (y-o-y, US\$ terms). Handicrafts exports have fallen by 54.7% (y-o-y US\$ terms) during Apr-Feb 09. Due to the sharp depreciation of the rupee vis-à-vis the USD, exports growth (in rupee terms) grew by 4% in Jan-09, albeit at a lower pace than the previous month. With fresh export



Source: Ministry of Commerce

orders drying up due to sluggish demand conditions, the rupee depreciation is also not likely to provide much cushion to exporters going forward. Imports, partly as a result of lower oil prices and partly on account of weaker domestic demand followed the course of exports, declining by 18% (y-o-y) in Jan-09. While Oil imports continued to slide in Jan-09, Non-oil imports witnessed their first decline in FY09. The 0.5% decline in non-oil imports is testimony to the combination of weak demand conditions and lack of export growth in industries which have a large import component- notably the gems and jewellery sector. With contracting exports and imports, the trade deficit has narrowed to US\$ 6 bn in Jan-09 as against US\$ 7.8 bn in Jan-08. While the Government has announced some trade facilitating measures in the interim foreign trade policy, exports are likely to remain grim for a major part of CY09 given the severity of the global economic downturn.

In the forex market, the rupee surged past the 50 per dollar mark towards the end of Feb-09 and also touched an intra-day low of 52.20 on 02-Mar-09. This was primarily owing to a plunge in global as well as domestic stock market, strong FII outflows coupled with a downgrade in India's long-term sovereign credit rating outlook from stable to negative by an international credit rating agency. We expect the pressure on rupee to ease in the near term owing to the resumption of special market operations by the RBI. The rupee is unlikely to depreciate further from the current levels and will be in the range of 51.20-51.50 per USD during Mar-09.

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

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