



Decide with Confidence

Dun & Bradstreet

ECONOMY OBSERVER

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With an expected growth of 9.2% in FY07 against 9% in the previous fiscal, backed by strong momentum in the services and manufacturing sectors, the Indian economy is placed among the fastest growing economies globally. There is however a short-term risk in the form of higher-than-acceptable inflation and rapid rupee appreciation driven mainly by strong capital flows.

Though benchmark wholesale price inflation slowed to a four-month low of 5.66% in the week ended 28-Apr-07, it is still ruling higher than the targeted 5% for the current fiscal. High money supply growth along with global factors like firming up of commodity prices, especially agricultural-commodities, and volatility in crude oil prices have kept up the inflationary pressures. However, both CPI and WPI inflation has started nudging down following "appropriate policy responses" by the Central Bank.

The Index of Industrial Production has grown at a 10-year high rate of 11.3% in the FY07 supported by 8.6% growth in the index of infrastructure industries. The exports growth rate has slowed down in recent months though both oil and non-oil imports have registered high growth. Rising trade deficit has been met by strong capital account inflows. The flows have put upward pressure on the rupee. The forex reserves in the economy continue to build up.

The RBI has however refrained from intervening in the FX market despite the rise in INR to keep its efforts focused on curbing inflation levels in the economy.

The Central Bank thus faces a complex task of balancing inflationary pressures, interest rate, currency valuation and forex inflows so as to maintain the growth momentum in the economy along with price stability.

Highlights of RBI's Annual Credit Policy Statement for the year 2007-08

- GDP growth projection for FY08 at around 8.5%
- Inflation to be contained close to 5.0% during FY08. The rate of inflation to be targeted in the range of 4.0-4.5% over the medium term.
- M3 expansion to be contained at around 17.0-17.5% during FY08.
- Bank Rate, Reverse Repo Rate and Repo Rate kept unchanged.
- Scheduled banks required to maintain CRR of 6.5% with effect from the fortnight beginning 28-Apr-07.
- Ceiling interest rate on FCNR (B) deposits reduced by 50 basis points to Libor minus 75 basis points while ceiling interest rate on NR(E)RA deposits reduced by 50 basis points to LIBOR/SWAP rates.
- Overseas investment limit for Indian companies enhanced to 300% of their net worth while Mutual Funds' overseas investment limit raised to US\$ 4 bn from US\$ 3 bn.

Key Economic Indicators

	Forecast	Latest Period	Previous Month
WPI	5.60% (May 07)	5.94%(Apr 07)	6.49%(Mar 07)
IIP Growth	11%(Apr 07)	12.9%(Mar 07)	11%(Feb 07)
91 day-T-Bills	8% (May 07)	7.35% (Apr 07)*	7.97% (Mar 07)*
INR/US\$	40-40.5 (May 07)	42.15 (Apr 07)	44.03 (Mar 07)

*all figures are monthly average, (y-o-y)
* end of the month*

Real Economy

Industrial Production at a 10-year high

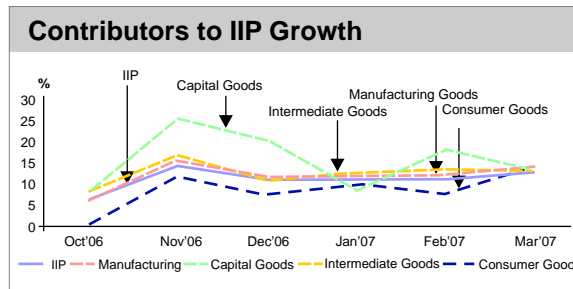
Though agriculture has remained a low contributor to overall GDP growth of the economy, the industry and services sectors are witnessing strong growth momentum.

The industrial sector is currently on a double-digit growth path. The index of industrial production (IIP) grew by 12.9% in Mar 07, taking the cumulative IIP growth for FY07 to a 10-year high of 11.3%. There is every indication of robustness in the economy with the manufacturing sector recording a growth of 14% in Mar 07, thereby pushing annual growth in the sector to 12.3%. The capital and intermediate goods sectors have also registered impressive growth rates of 13.2% and 13.3% respectively in Mar 07, indicating strong investment activity in the economy. There however exists a downside risk from increasing interest rates. Growth in the consumer goods sector has slowed down to 10% in FY07 from 12% in FY06, mainly driven down by consumer durables which saw a sharp fall to 9%, down from over 15.3% in the previous fiscal.

The index of infrastructure industries also recorded growth of 10% in Mar 07 as compared to 7.1% in the year-ago month. The aggregate growth for FY07 stands at 8.6% compared to 6.2% in the previous fiscal. A turnaround in crude petroleum production to 5.6% in FY07 from a decline of 5.3% in FY06 and a strong growth in petroleum refinery products (12.6% in FY07 as against 2.4% in FY06) has largely driven the growth in infrastructure industries during the current fiscal. Growth rates in cement and finished steel production were however lower than last year at 9.1% and 10.9% respectively.

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Industrial production is likely to continue with its current momentum though there might be a slight moderation following interest rate hikes. We expect the IIP growth rate to be at around 11% in Apr 07.



Source: MoSPI, D&B Research

Price Scenario

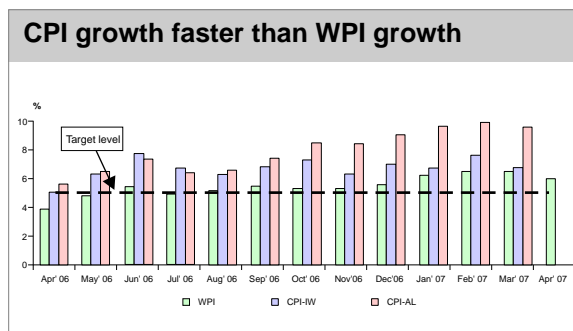
Inflation turning southwards, still above Central Bank's target level

Following the recent monetary and supply side measures to curb domestic inflation, and aided by high base effect, the WPI inflation level has started showing a downward trend from around 6% levels in preceding weeks. WPI inflation for the week ending 21-Apr-07 stood at 5.8% on account of high prices of both primary products and some manufactured products. The headline inflation level is however still running much above the reduced inflation target of 5% for FY08.

The CPI growth rate for industrial workers (CPI-IW) stood at 6.72% in Mar 07, driven by rises in the prices of food grains, edible oils, fruits and vegetable prices. CPI numbers have however also shown slight moderation compared to previous months, reflecting a marginal effect of the Government's efforts to contain inflation.

In view of strong economic activity, rapid growth of broad money and credit, increase in commodity prices world over and international crude oil prices nudging up again, we expect the domestic inflation levels to continue to remain above target in near term.

However, in spite of the above mentioned risks, both CPI and WPI inflation is expected to moderate from its current level in coming months, given the commitment of the Central Bank towards "conduct of monetary policy to ensure price stability, backed by timely and appropriate policy responses". Apart from policy decisions, prospects of good monsoons and growth in agriculture output will be an important factor for attaining the target level of inflation. A strong base effect is also expected to play a role in moderating inflation from its current high levels. We expect the WPI growth rate to average at around 5.6% in May 07.



Source: RBI, D&B Research

Money & Finance

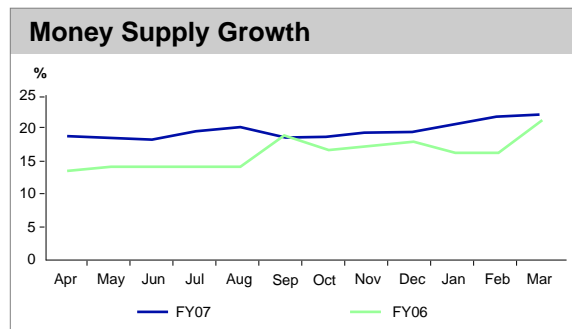
No change in key policy rates in the annual credit policy

The Central Bank in its annual credit policy has reiterated its commitment towards controlling inflation levels in the economy. The key rates viz, Bank Rate, Repo Rate and Reverse Repo rates have however been left unchanged at 6%, 7.75% and 6% respectively. Money supply growth rate has been targeted to be contained at around 17.0-17.5% during FY08.

The short term interest rates are reigning around 7.5%, with the 91-day Treasury bill yield touching 8% in Apr 07. Money supply in the economy continues to grow at more than 20%, funded primarily by huge capital inflows from abroad and continued high growth in non-food credit.

Capital flows from all accounts, FDIs, FIIIs as well as debt flows are substantially large and this, to a certain extent, has diluted the impact of monetary measures taken by the RBI as it has boosted liquidity in the system and in turn fuelled credit growth.

In view of some moderation in the inflation levels in the economy and expected squeeze in money supply following Central Bank's efforts, we expect the short term interest rates to average around 8% in May 07.

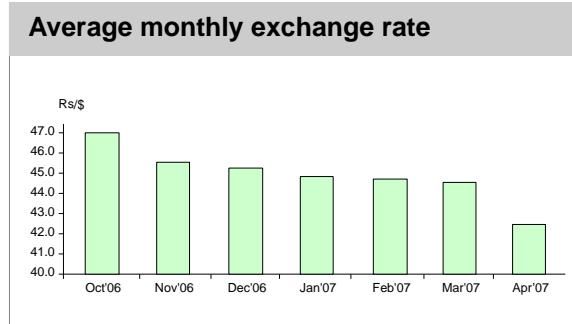


Source: RBI, D&B Research

External Sector

Domestic currency continuing on an appreciating path

Though India's exports in FY07 have almost touched the targeted level, there has been a pronounced slowdown in export growth rate in the last few months. Merchandise exports registered a growth rate of 8.84% during the month of Mar 07 and 20.93% growth in the cumulative exports for the period April-March, 2007 over the same period last year. The total exports for FY07 at US\$124.6 bn missed the target of US\$ 125 bn by US\$ 371 mn in spite of an upward revision in the exports data for Apr-Feb 07 by about US\$3 bn.



Source: RBI, D&B Research

Cumulative imports for FY07 have grown by 26.45%, of which crude oil imports grew by 30.31%. Growth in non-oil imports was also high at 24.74% for the period led by imports of capital goods, indicative of strong investment demand.

Buoyant net surplus under invisibles along with capital inflows, have financed a large part of the deficit on the merchandise trade account. The forex reserves in the economy continue to build up and have reached US\$ 204 bn as on 27-Apr-07.

On the back of inflow of foreign funds, domestic currency has continued on its appreciating trend. The Rupee/US Dollar touched a nine-year high of 40.53. The Central Bank has however refrained from intervening in the forex market to keep its efforts focused on curbing inflation levels in the economy.

The appreciation of the currency is not likely to reverse drastically in the short term given the government's commitment towards controlling inflation and continued surge in capital inflows. In the event of this happening, and the central bank staying away from intervening, we expect the average value of the rupee to be in the range of 40.50-41 to a dollar for May 07.

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

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