



Decide with Confidence

Dun & Bradstreet

ECONOMY OBSERVER

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Industrial production figures for Mar 08 continue to point towards a slowdown; the Index of Industrial Production (IIP) grew by just 3% in Mar 08, taking total growth in IIP to 8.1% for FY08. There is increasing evidence that high interest rates, the resultant slowdown in demand and rising raw material costs have had an adverse impact on industrial production during the last fiscal. Growth in IIP slowed down from an average of 10.3% during Q1 FY08 to an average of 8.7% in Q2 FY08 and further to an average of just 5.8% during the last quarter of FY08. Even the capital goods sector, which witnessed strong growth rates until Dec 07, has started to display signs of a slowdown in recent months. This could be reflective of the adverse impact of high interest rates on the corporate sector's capacity expansion plans.

A notable aspect of IIP growth is that production in the Metals Products and Parts group declined during Mar 08, pulling down growth in IIP by almost 26%. High steel prices may be one of the factors behind the decline in production within this segment. Iron and steel contributed as much as 15% to the overall increase in WPI inflation during Mar 08. During Apr 08 as well, the Iron and Steel category contributed 17% to WPI inflation. In fact, when we exclude the Iron and Steel category from the WPI basket, inflation during Apr 08 falls from 7.4% to 6.1%. Prices of food articles and food products also remain high.

Given the high inflationary pressures, the Government has taken several measures such as the suspension of futures trading in soya oil, chana, rubber, potato as well as various fiscal incentives to raise supplies of steel and cement. However, these measures may have a limited impact as supply side constraints caused by lower production will persist in the near future. With the rupee depreciating to 42 to a US Dollar (as on 12-May-08) (a depreciation of almost 5% from the average value seen in Jan 08) and with high global prices, imported inflation may increase.

Liquidity also remains a prime concern with money supply growing by 21.2% (25-Apr-08). In addition to hikes in the Cash Reserve Ratio by a total of 75 basis points during April and May, the RBI has resorted to the reverse repo window under the Liquidity Adjustment Facility to a large extent. We expect the RBI to continue with its liquidity tightening measures during the months to come. However, given the current high inflationary pressures, we do not expect interest rates to decline until the end of 2008.

Dun & Bradstreet's Macro Economic Forecasts

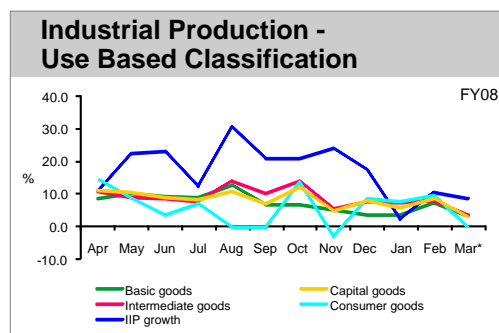
	FORECAST	ACTUALS	
		Latest Period	Previous Month
Inflation (W.P.I)	7.4%-7.6%(May-08)	7.41%(Apr-08)	6.75%(Mar-08)
IIP Growth	6.0%-7.0%(Apr-08)	3.01%(Mar-08)	8.64%(Feb-08)
15-91-day T-Bills	6.8%-7.0%(May-08)	6.60%(Apr-08)	6.76%(Mar-08)
INR/US\$	41.5-41.7(May-08)	40.03(Apr-08)	40.36(Mar-08)

All figures are monthly averages

Real Economy

Metal Products & Parts pulls down IIP growth by almost 26%

Industrial production growth (measured by the IIP) for the month of Mar 08 grew by just 3%, (a 6 year low) taking growth in IIP for FY08 to 8.1%. There is increasing evidence that high interest rates, the resultant slowdown in demand and rising raw material costs have had an adverse impact on industrial production during the last fiscal. Growth in IIP slowed down from an average of 10.3% during Q1 FY08 to an average of 8.7% in Q2 FY08 and further to an average of just 5.8% during the last quarter of FY08. Although high interest rates and rising raw material costs were the prime factors behind the moderation in IIP growth during Mar 08, the sharp slowdown in production growth can also be attributed to the high base of the previous year (IIP had grown by 14.8% during Mar 07). All three sectors, i.e., mining, manufacturing and electricity, witnessed lower growth rates at 3.8%, 2.9% and 3.7% respectively in Mar 08. Within the manufacturing sector, a decline in production of Metal Products & Parts other than machinery, pulled down IIP growth by around 26%. It is possible that high prices of raw materials such as steel and iron ore have played a role in the decline in production within this segment.



Source: CSO

As per used based classification, production in capital goods sector grew by 8.6% during Mar 08 as compared with 10.4% in the previous month. We believe that the slowdown in production of capital goods could be a result of the impact of high interest rates on the corporate sector's capacity expansion plans. Further, there has also been a slowdown in total outstanding investments in the manufacturing sector over the last few quarters. The considerable moderation in demand (in response to high interest rates) is reflected in the 0.1% decline in production of Consumer goods. High input prices, moderating investment growth and a slowdown in demand are likely to continue to have a bearing on industrial production during FY09. We expect IIP to have grown within the 6-7% range during Apr 08.

Price Scenario

Iron & Steel contributes 17% to WPI inflation during Apr 08

Inflation, as measured by the WPI, surged to a near three and half year high of 7.6% during the week ended 26-Apr-08, far above the RBI threshold limit of 5.5% set for FY09. During the month of Apr 08, inflation stood at 7.4% driven primarily by a sharp rise in prices of mineral, fuels and certain manufactured products. The growing demand for crude oil coupled with constrained supply from existing sources placed upward pressure on global crude oil prices, in turn, spurring inflation in industrial fuels. Amongst the manufactured products, prices in the Basic Metal Alloys and Metals Products group continued to move northwards and contributed almost 23% to headline inflation during Apr 08. The sharp increase in prices witnessed in this group was driven by a steep rise in steel prices, which in turn, was spurred by a substantial increase in iron ore prices. The WPI for minerals rose by as much as 45% during Apr 08 as compared to 22.1% during the previous month.

Contribution to WPI Inflation (%)

	Apr-07	Apr-08
Primary articles	39.0	24.7
Food articles	23.2	10.4
Non-food articles	14.8	9.2
Minerals	1.1	2.9
Fuel, power, light & lubricant	2.2	13.1
Manufactured products	58.8	62.3
Food products	9.0	14.4
Edible oils	6.1	5.5
Iron & steel	5.1	17.0

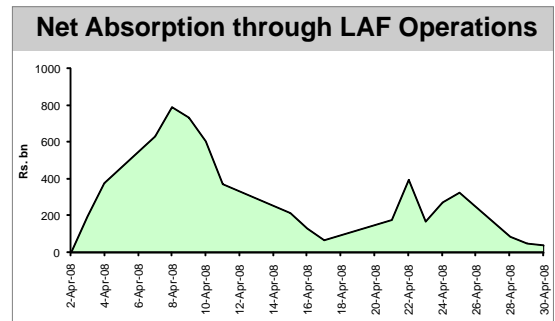
Source: Ministry of Commerce

Food product prices also remained elevated. As a result, inflation in the manufactured products group rose to 7.3% during Apr 08 from 6.3% during Mar 08. Inflation in edible oils, however, moderated to 14.9% during Apr 08 from the one-year high of 19.4% recorded during the previous month. It is possible that the cut in duties on refined oils played a role in moderating edible oils inflation. With a rise in prices of food articles, especially cereals, the CPI for Industrial Workers and the CPI for Agricultural Labourers grew by 7.87% and 7.91% during Mar 08. The Government has initiated certain short term measures such as a ban on exports and a suspension of futures trading in a few commodities, in order to contain the rise in domestic prices. However, given that supply side pressures on food prices are likely to continue during the next few months, we expect WPI inflation to average between 7.4-7.6% during May 08.

Money & Finance

Cash Reserve Ratio expected to absorb over Rs 180 bn during May

In line with D&B expectations, the RBI, in its Monetary Policy for FY09, raised the Cash Reserve Ratio (CRR) by 25 basis points to 8.25% (effective 24-May-08) to absorb excess liquidity. Liquidity remains the prime concern with money supply growing at 21.2% (y-o-y, as of 25-Apr-08), mainly driven by the 45.2% (y-o-y) increase in the net foreign exchange assets of the banking system. The RBI has now raised the CRR by as much as 75 basis points effective in 3 phases during the months of April and May. While the initial 50 basis points hike in the CRR announced prior to the Monetary Policy is expected to have absorbed approximately 185 bn from the banking sector, the most recent 25 basis points hike should absorb over Rs 90 bn. This takes the total amount absorbed through the increase in the Cash Reserve Ratio (during April and May) to over Rs 275 bn. Further, the RBI also resorted to Liquidity Adjustment Facility operations to a large extent. Net absorption of funds through the LAF corridor amounted to as much as Rs 5664.3 bn during the month of April. It is thus evident that the RBI is concerned over the excess liquidity in the system and its potential impact on inflation. Given that inflationary pressures are expected to sustain during the next few months, we do not expect interest rates to decline atleast until the end of 2008. In the G-sec market, the yield on the 10 year benchmark gilt eased to 7.84% (as on 2-May-08) backed by the RBI's decision to keep key interest rates unchanged in its Monetary Policy for FY09. The 15-91 day treasury bills yield remained in the range of 5.7-7.4% during Apr 08. Further, we expect 15-91 day treasury bills yields to remain in the 6.8-7.0% range during May 08.

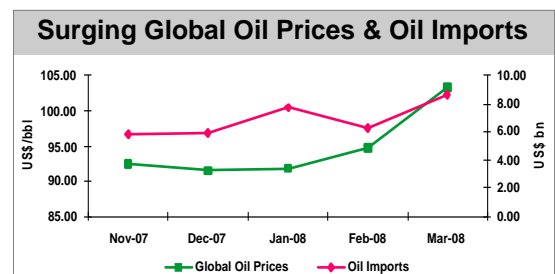


Source: RBI

External Sector

Exports fall short of target for FY08 by approx. US\$ 4.5 bn

Exports (both in dollar terms and in rupee terms) witnessed reasonable growth during H2 FY08 – thus offsetting the low growth witnessed during the first half of the last fiscal. It is possible that measures taken by several exporters to hedge against currency risk have played a role in improving export realisations during H2 FY08. Exporters have taken recourse to the forwards market to cover the US Dollar and/or denominated a significant portion of export contracts in currencies other than the US Dollar. Exports in dollar terms grew by 23.0% (y-o-y) during FY08, slightly higher than the exports growth of 22.6% registered during FY07. However, as we had expected, it fell short of the exports target of US\$ 160 bn set for FY08 by almost US\$ 4.5 bn. Exports in rupee terms, on the other hand, grew by just 9.4% (y-o-y) during FY08.



Source: Ministry of Commerce

With global oil prices surging by almost 53% during the FY08 period, India's oil import payments witnessed a significant increase. Oil imports registered a considerable rise of 76.6% (y-o-y) (in dollar terms) in Mar 08 with its share in total imports rising to 37.3% in Mar 08 as against 28.5% in Mar 07. As a result, overall imports (in dollar terms) grew by almost 35.2% (y-o-y) in Mar 08, leading to a widening of the trade deficit to US\$ 6.9 bn. During FY08 period, the trade deficit rose by 35.5% (y-o-y) to US\$ 80.4 bn. On the forex reserves front, growing foreign capital inflows spurred India's forex reserves to US\$ 312.9 bn as on 25-Apr-08 (from US\$ 204.1 bn as on 27-Apr-07), making it the third largest stock of reserves among emerging market economies. However, with the sub-prime mortgage crisis; growing risk aversion amongst global investors may result in a slowdown of foreign capital inflows in the coming months. In the forex market, the rupee crossed the 42 to a Dollar mark (as on 12-May-08) owing to oil importer-led dollar demand. In view of a slowdown in foreign capital inflows coupled with an upsurge in oil importer-led dollar demand, we expect the rupee to remain in the range of 41.5-41.7 during May 08.

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

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