



Decide with Confidence

Dun & Bradstreet

ECONOMY OBSERVER

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As we had expected, the RBI raised the Cash Reserve Ratio by 50 basis points to 7.5% in its mid term review of the Annual Monetary Policy. The 50 basis points hike in the CRR is expected to have absorbed approximately Rs 150 bn from the banking system. However, this may not result in an increase in lending rates in the near future, given the current scenario of ample liquidity – backed by sustained capital inflows and a moderation in credit offtake. Some banks, however, have already reduced their deposit rates, so as to protect their net interest margins following the hike in the CRR.

Liquidity conditions remain abundant; money supply, as measured by M3, grew by 22.5% (26-Oct-07), the highest in a decade, driven by a 33% increase in net foreign exchange assets of the banking sector. Growth in credit offtake has moderated (to about 22.5% as of 26-Oct-07) as the RBI's monetary tightening measures continue to impact lending.

The impact of monetary tightening measures was also displayed in industrial production numbers. The Index of Industrial Production grew by 6.4% in Sep 07 (as compared with 12% in Sep 06) with consumer durables production declining by as much as 7.6% during Sep 07. This decline in consumer durables production assumes even more significance when we take into consideration the fact that consumer durables production usually increases just before the festive season.

Although, inflation, as measured by the Wholesale Price Index appears contained, the complete pass through of international oil prices has not yet been realised. The Government has been issuing oil bonds to state-run oil refiners in order to compensate them for losses incurred, resulting in further pressure on the fiscal front. However, given that crude oil prices have surged to the US\$95 - US\$100 per barrel range, the question of sustainability of issuing oil bonds does arise.

Given the economic fundamentals and the interest rate scenario, we expect capital inflows to remain strong, thereby placing upward pressure on the rupee. Any attempt to put a cap on the rupee's gains through sterilisation will result in a further increase in liquidity. Liquidity management will therefore remain at the forefront of the RBI's monetary stance in the months to come; the hike in the MSS to Rs 2500 bn from Rs 2000 bn will absorb only a part of the liquidity. We may therefore see further measures taken by the RBI to moderate capital inflows and liberalise capital outflows in the near future.

Dun & Bradstreet's Economy Forecast

	FORECAST	ACTUALS	
		Latest Period	Previous Month
Inflation (W.P.I)	2.9%- 3.1%(Nov-07)	3.03%(Oct-07)	3.3%(Sept-07)
IIP Growth	8.5%-9.5%(Oct-07)	6.4%(Sept-07)	10.7%(Aug-07)
15-91-day T-Bills	7.0%-7.2%(Nov-07)	6.68%(Oct-07)	6.79%(Sept-07)
INR/US\$	39.25-39.45(Nov-07)	39.51(Oct-07)	40.34(Sept-07)

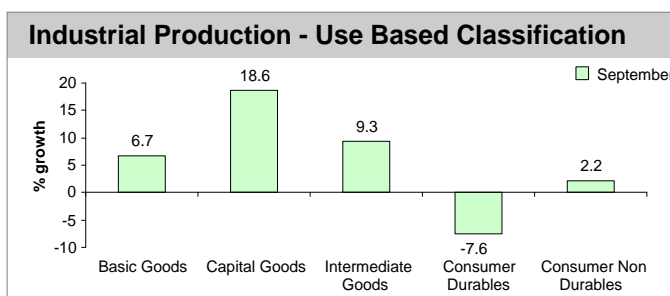
All figures are monthly averages, (y-o-y)

Real Economy

Consumer Durables sector pulls down Index of Industrial Production

The impact of monetary tightening measures continues to manifest itself on industrial production numbers. Industrial production, measured by the IIP, grew by 6.4% in Sep 07 – the slowest growth witnessed during the last 11 months.

Weak consumer demand in the face of high interest rates has forced manufacturers to cut down production. Manufacturing, which accounts for almost 80% of the IIP basket, grew by just 6.6% in Sep 07 as compared with 12.7% in Sept 06. The Index of consumer durables production, in particular, declined by as much as 7.6% during Sep 07; this assumes even more significance when we consider the fact that consumer durables production tends to increase just before the festive season.



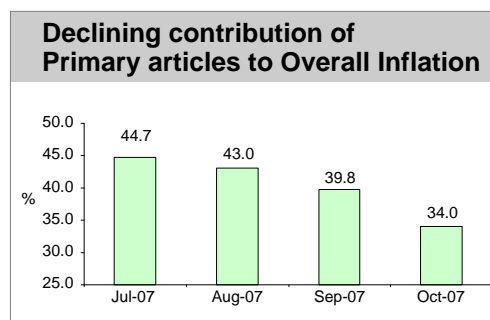
Source: CSO

However, sectors such as the Wood & Wood Products, Basic Chemicals & Chemical Products, Basic Metal & Alloy industries and Other Manufacturing Industries registered impressive growth rates and accounted for approximately 60% of the growth in IIP. The capital goods sector registered an impressive growth rate of 18.6%, indicating a continued step-up in capacity additions. Total outstanding investments in the manufacturing sector stood at Rs 13,861.8 bn while outstanding investments in the construction sector stood at Rs 6,573.4 bn as of Nov 07. Given the low base of the previous year, we expect growth in industrial production to increase marginally and be in the range of 8.5-9.5% during Oct 07.

Price Scenario

Inflation falls to a one year low of 3.02% during Oct 07

Inflation, as measured by Wholesale Price Index (WPI) moderated to 2.97% for the week ended 27-Oct-07. In Oct 07, inflation fell to a one year low of 3.02%, largely driven by the high base effect (the inflation rate for the corresponding period of the previous year was 5.5%). The inflation rate of primary articles also moderated to 5.39% in Oct 07 as compared to 7.09% in Sep 07. Amongst the primary articles, food articles witnessed a significant fall in inflation to 3.46% in Oct-07, (as compared to 5.36% in Sep 07) and accounted for about 15% of overall inflation. The decline in food article prices was mainly driven by a moderation in the inflation rate of food grains and a 1.02% decline in the prices of fruits and vegetables. Manufactured products also witnessed a modest fall in inflation to 4.0% in Oct 07 as against 4.27% in the previous month. Prices of items such as sugar and textiles, in particular, declined sharply. However, a sharp decline in sugar prices was, in part, offset by a double digit growth in edible oil inflation witnessed during the festive season.



Source: Ministry of Commerce

Although, consumer price inflation as measured by the Consumer Price Index (CPI) witnessed a moderation in Oct 07 as compared to the previous month, it remained higher than the WPI. The CPI for Industrial Worker (CPI-IW) grew by 6.4% in Sep 07.

The RBI has reiterated its commitment towards containing overall inflation close to 5% during FY08, with a medium term objective of inflation at around 3% in the mid-term review of its annual monetary policy. However, a sharp surge in global crude oil prices to the US\$95-US\$100 per barrel range, does pose a risk to the inflation scenario. We expect WPI inflation to average at around 2.9-3.1% during the month of Nov 07.

Money & Finance

Call rates rise following a hike in the CRR

With money supply growing at a decade high of 22.5% (as on October 26, 2007), the RBI continued its liquidity tightening measures and announced a hike in the Cash Reserve Ratio (CRR) by 50 basis points to 7.5% in the mid-term review of its annual monetary policy. This is expected to have absorbed approximately Rs 150 bn from the banking system. Subsequent to the hike in the CRR, some banks have reduced their deposit rates in order to protect their net interest margins.

In addition to the monetary tightening measures taken at the mid-term review, the RBI has also recently revised the ceiling for outstandings under the Market Stabilisation Scheme (MSS) for FY08 to Rs 2,500 bn (from the existing limit of Rs 2,000 bn). As a result of these measures, call rates in the inter-bank money market (which had stabilised at around 6% in Oct 07) rose to 8.00-8.25% on 12-Nov-07.

Other measures taken to contain capital flows such as the proposal to restrict the issuance of participatory notes to FII's triggered volatility in the domestic stock market, leading the Sensex to crash by 1,744 points in early trades on October 17, 2007. However, it recovered after the issue of participatory notes was clarified and surged well past the 19,000 mark. With strong capital inflows placing upward pressure on the rupee, the RBI may take some measures to moderate foreign capital inflows and further liberalise capital outflow norms in the months to come. The 15-91 day treasury bills yield remained in the range of 6.25%-7.35% during Oct 07. We expect 15-91 day T-bills yield to be in the range of 7.0-7.2% in Nov 07.

Monetary Indicators				
	FY07	Aug 07	Sep 07	Oct 07
M3*	21.3	20.0	21.0	22.5
Bank Credit*	28.0	22.8	21.9	22.5
Non Food Credit*	28.4	23.2	22.1	23
Prime Lending Rate** (%)	12.5	13.3	13.3	13.3
5 year G-secYield (%)	8.0	7.8	7.7	7.7
Inflation (%)	5.4	3.9	3.3	3

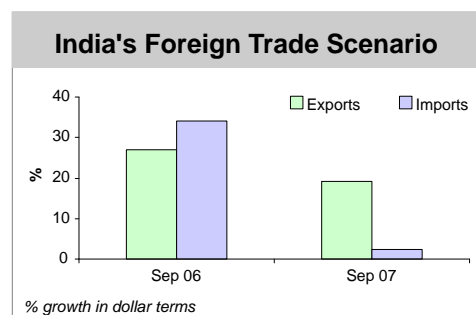
* Figures are percentage y-o-y growth ** maximum PLR
All figures (excluding inflation) are as at end of the month
Source: RBI

External Sector

Rupee remains strong amidst robust FII inflows

Despite the rupee appreciation, growth in exports (in dollar terms) witnessed a marginal rise to 19.3% (y-o-y) in Sep 07, as compared to 18.9% (y-o-y) in Aug 07. In rupee terms, exports grew by 4.31%, largely unchanged from the previous month. Although exports growth did witness an increase in Sep 07 on a m-o-m basis, it is still lower than the growth witnessed during the corresponding month of the previous year. In Sep 06, exports in dollar terms had grown at 27% (y-o-y), while exports in rupee terms witnessed a growth of 33.35%.

In Sep 07, imports in rupee terms declined by 10.51% (y-o-y) primarily due to a high base. In dollar terms, imports grew by a meager 2.31%, primarily due to a 0.15% (y-o-y) decline in non-oil imports. A moderation in oil imports growth to 8% as compared to 19.52% in the previous month also contributed to a slowdown in overall imports growth in Sep 07.



Source: Ministry of Commerce

A proposal of restricting the issuance of participatory notes by FIIs triggered a sell-off by foreign investors, leading the rupee to decline to 39.98 (intra-day) on October 17, 2007. The rupee, however appreciated in the latter half of October, owing to strong FII inflows after the issue regarding the proposed curbs on participatory notes was clarified. FIIs were net buyers in equities to the tune of US\$ 5.1 bn in Oct 07. Forex reserves (month end) increased to US\$ 266.518 bn (as on November 02, 2007) as against US\$ 247.76 bn (as on September 28, 2007).

Given the current domestic economic scenario and a further reduction in the Fed rate by 25 basis points to 4.5%, robust capital inflows can be expected; placing upward pressure on the rupee. However, the RBI's intervention in the forex market and a sharp rise in global crude oil prices could put a cap on the rupee's gains. We expect the rupee to continue to appreciate and be in the range of 39.25-39.45 during the month of Nov 07.

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

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