



Decide with Confidence

Dun & Bradstreet

# ECONOMY OBSERVER

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In an endeavour to maintain domestic macroeconomic and financial stability amidst turmoil in the global financial markets, the RBI announced a slew of measures which include cut in the CRR, repo rate and SLR. The reduction in CRR and SLR coupled with the first installment of the agriculture debt waiver scheme led to augmentation of liquidity to the extent of Rs 2,050 bn. This apart, the net injection of Rs 9,279 bn through the repo window during Oct-08 and the repurchase of MSS bonds worth Rs 200 bn by the central bank helped to ease liquidity pressures in the system, thereby leading call rates to ease.

While a severe liquidity crunch was witnessed in the banking system, bank credit continued to remain robust – registering a growth of 29.03% as on 24-Oct-08 as against 24.78% as on 26-Sep-08. The substantial increase in bank credit can in part be attributed to drying up of external financing route for corporate sector due to global liquidity crunch and the rise in risk aversion amongst international investors. External commercial borrowing by Indian companies amounted to US\$ 8.47 bn during H1 FY09 as against US\$ 11.13 bn during H1 FY08. Further, the domestic stock markets have been in a bearish mode during the last few months, making it difficult for the corporates to raise funds from this route and thereby increasing their recourse to the banking system for raising funds.

Further, high input costs coupled with the rising interest rates have adversely impacted the growth momentum during the first half of the current fiscal as is evident from the slowdown in IIP growth to 4.94% during H1 FY09 as compared to 9.49% during H1 FY08. Even growth in capital goods production has almost halved to 10.76% during H1 FY09 as compared to 20.05% during H1 FY08 which is indicative of moderation in investment activity across industries. However going forward, easing interest rates backed by the RBI's easy monetary policy stance are likely to help the corporates to raise cheaper funds domestically and would provide some impetus to the investment activity in the long run. Nonetheless, subdued demand conditions in the domestic economy and a slump in exports growth owing to slowdown in global economy are likely to hamper the industrial production in the near future. D&B therefore expects IIP growth to moderate and remain close to 5.1% during FY09.

### Dun & Bradstreet's Macro Economic Forecasts

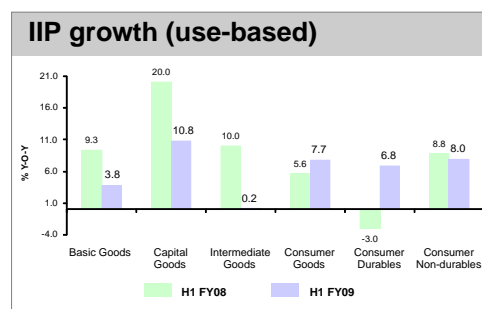
	FORECAST	ACTUALS	
		Latest Period	Previous Month
<b>Inflation (W.P.I)</b>	8.80%-9.10%(Nov-08)	10.98%(Oct-08)	12.02%(Sept-08)
<b>IIP Growth</b>	2.50%-3.50%(Oct-08)	4.80%(Sep-08)	1.42%(Aug-08)
<b>15-91-day T-Bills</b>	6.8%-7.0%(Nov-08)	7.52%(Oct-08)	8.62%(Sept-08)
<b>INR/US\$</b>	48.00-48.40(Nov-08)	48.64(Oct-08)	45.56(Sept-08)

*All figures are monthly averages*

## Real Economy

### IIP growth halved during H1 FY09

After experiencing a sharp dip in growth during Aug-08, the Index of Industrial Production rebounded to some extent and registered a growth of 4.8% (y-o-y) during Sep-08 as manufacturers raised their production in anticipation of rise in demand ahead of festive season. However, growth in IIP during Sep-08 was lower as compared to 6.98% registered during Sep-07. Moreover, IIP growth has almost halved to average at 4.94% during H1 FY09 as compared to 9.49% during H1 FY08, indicating moderation in the growth momentum during the current fiscal. High interest rates coupled with high input costs seems to have weighed down industrial production during the first half of the current fiscal.



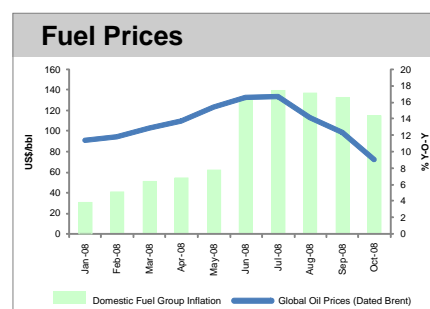
Source: CSO

Production of Basic metal and alloy industries, Metal products and parts (except machinery and equipment), Machinery and equipment other than transport equipment, Transport equipment and parts registered robust growth, reviving the growth in manufacturing sector to 4.77% during Sep-08 as compared to a mere 1.4% during Aug-08. As per use-based classification, the growth of consumer durables (13.06%) gained momentum, taking the growth in consumer goods sector to 5.56% during Sep-08. The production of consumer durables might have picked up during Sep-08 due to the forthcoming festive season demand. The capital goods sector also registered an impressive growth of 18.76% during Sep-08 as compared with 0.87% during Aug-08, thereby contributing almost 42.42% to the overall growth in the IIP. However, growth in capital goods production has almost halved to 10.76% during H1 FY09 as compared to 20.05% during H1 FY08 which is indicative of moderation in investment activity across industries. Going forward, subdued demand conditions in the domestic markets coupled with moderating exports growth due to a slowdown in the world economy are likely to have adverse impact on the domestic industrial production in the near future. Thus D&B expects IIP to have grown within the 2.5-3.5% range during Oct-08.

## Price Scenario

### Inflation eases to single digit level

With the significant decline in global prices of crude oil, metals and edible oils, domestic inflation has shown signs of moderation. The substantial decline in the headline inflation during the month of Oct-08 is primarily due to a moderation in inflation of minerals oil and manufactured food products. The headline inflation averaged at 10.98% during Oct-08 (an average of first four weeks) as against 12.02% during the previous month. Further, the latest release of inflation data reveals that the WPI inflation eased to 8.98% for the week ended 01-Nov-08.



Source: IMF & Ministry of Commerce

Inflation in manufactured food products which was in double digits for the last five months, plummeted to 8.39% during Oct-08. The considerable moderation in prices of manufactured food products was primarily due to the moderation in the prices of grain mill products and oil cakes. Further, the deflationary trends witnessed in global prices of edible oils like palm oil and soybean oil has led to moderation in domestic edible oil prices. Besides, prices of textiles (cotton & man-made textiles), which continued to moderate largely due to receding prices of raw materials prices (particularly, cotton yarn and man-made fibre) and fall in demand domestically and internationally, pulled down inflation in manufactured products to 9.39% during Oct-08 as against 10.57% during the previous month.

Inflation in primary articles surged to 11.64% during Oct-08 driven by the sharp rise in prices of fruits & vegetables amidst festive season demand. Price of fruits & vegetables, which shot up to 12.14% during Oct-08 as against 4.68% during the previous month, contributed around 3.23% to the headlines inflation.

With a sharp fall in global crude oil prices, inflation in aviation turbine fuel, naphtha and furnace oil (which are not administered) witnessed significant slowdown, in turn, their contribution to the headline inflation dropping to 4.43% during Oct-08 as against 6.02% during Sep-08. Further, the latest data release for inflation reveals that inflation in fuel group declined by 3.4% (w-o-w) for the week ended 01-Nov-08. D&B expects WPI inflation to average between 8.80-9.10% during Nov-08.

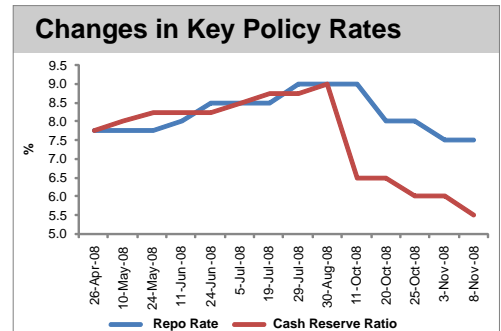
## Money & Finance

### Call rates ease on liquidity support provided by the RBI

In view of the intensifying global financial crisis and consequent liquidity crunch in the domestic financial system, the RBI announced a slew of measures during Oct-08 to improve liquidity conditions, boost investor confidence and attract foreign investment. Since 01-Oct-08 till date, the RBI has reduced the CRR and repo rate by a cumulative 350 basis points and 150 basis points respectively. The cut in the CRR to 5.50%, 1 percentage point cut in SLR to 24% and the first installment of the agriculture debt waiver scheme provided liquidity support to the extent of Rs 2,050 bn. In addition, the net injection of Rs 9,279 bn through the repo window during Oct-08 and the repurchase of MSS bonds worth Rs 200 bn by the central government during Nov-08 helped to alleviate the liquidity pressures in the system.

As a result, call rates which had shot up to 17.00-17.50% (as on 31-Oct-08) eased to around 6.20-7.80% during the first week of Nov-08. 15-91 day T-Bills yields were in the range of 6.40-7.44 for the week ended 31-Oct-08. Moreover, with the reduction in repo rate to 7.50%, some banks announced cut in their lending rates that led PLR to decline to 12.75-13.25% as on 12-Nov-08 from 13.75-14% during Oct-08.

In the stock market, the benchmark Sensex declined by as much as 23.89% during Oct-08 on account of a sharp fall in global indices as well as heavy FII outflows in the wake of worsening of global financial crisis. Although the recent measures announced by the RBI have resulted in easing of liquidity conditions, given the sustained FII outflows from the domestic equity markets and the RBI intervention in the forex market through sale of US Dollars, liquidity is likely to come under pressure once again in the coming weeks. D&B therefore expects further cut in the CRR and repo rate by 50 basis points each in the near future, which will lead to further reduction in short term interest rates. D&B expects 15-91 day T-Bills yields to average at around 6.8-7.0% in Nov-08.



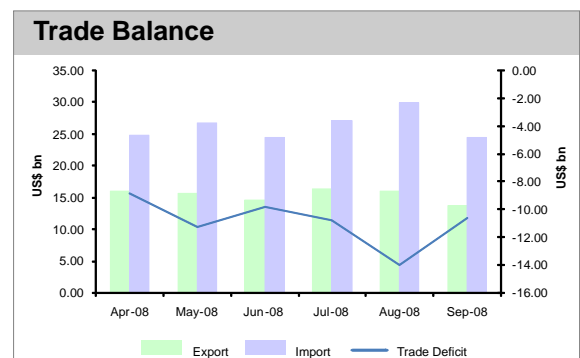
Source: RBI

## External Sector

### Slowing global economy adversely impacts the Indian Exports

The global financial crisis and the consequent slowdown in the world economy are adversely affecting India's merchandise exports. Growth in Exports (in dollar terms) plunged to 10.38% in Sep-08 as compared with 26.89% in Aug-08. The ripple effects of global financial turmoil on the real sector of various countries has not only dampened India's exports but also has increased exporter's risk on the credit given to buyers. According to the Federation of Indian Exporters (FIEO), insurance firms have hiked premium rates by 25-30% for export credit insurance covers. Moreover, the unwillingness of Indian banks to accept Letter of Credits issued by foreign banks due to fear of default is putting pressure on the Indian exporters.

Thus, we expect exports growth to slowdown significantly in the near future. While exports grew by just 10.38% during Sep-08, imports surged by as much as 43.3%, leading to a trade deficit of US\$ 10.63 bn. Trade deficit during H1 FY09 has mounted to a record US\$ 65.23 bn as compared to US\$ 39 bn during H1 FY08. Going forward, D&B expects trade deficit to widen further and likely to be around US\$ 121 bn during FY09.



Source: Ministry of Commerce

While the trade deficit has been mounting, there has been a run down upon the foreign exchange reserves, which declined by almost US\$ 59 bn to US\$ 252.88 bn as on 31-Oct-08 (from 311.88 bn as on 4-Apr-08). This, in part, could be attributed to the RBI's intervention in the forex market to support the depreciating rupee. The turmoil in the global financial markets and the resultant FIIs outflow led the rupee to depreciate as much as 6.7% between 1-Oct-08 to 27-Oct-08. However, FII inflows in the domestic equity markets and sale of US Dollars by exporters during the first week of November provided some respite to the rupee. Given the volatility in the domestic stock markets and FII flows, D&B we expect the rupee to be in range of 48.00-48.40 to a US\$ during Nov-08.

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

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