



Decide with Confidence

Dun & Bradstreet

ECONOMY OBSERVER

Issue 6 | October 2007

Contents

[View from the top](#)

Page 1

[Real Economy](#)

[Price Scenario](#)

Page 2

[Money & Finance](#)

[External Sector](#)

Page 3

[View from the top](#)

Growth in industrial production, measured by the IIP, has exceeded our expectations. IIP grew by 10.7% during the month of Aug 07, driven by strong growth in the manufacturing sector (accounting for almost 75% of the growth in IIP). The capital goods sector continued to record significant growth (30% in Aug 07) indicative of sustained high investment activity which augurs well for future growth prospects. The only blip in industrial production numbers is from the consumer goods sector, wherein growth in the consumer durables sector declined by 6.2%, as the impact of higher interest rates on consumer spending continued to manifest upon consumer durables' production numbers. However, consumer goods production is expected to recover during the next few months on account of festive demand, which will provide some support to overall IIP. Findings of the D&B Business Expectations Survey for the Oct-Dec 07 quarter also reveal a sense of high optimism amongst respondents from the consumer durables sector.

Although inflation displayed a downward trend during most of September as inflationary pressures on some food articles eased to an extent, prices of primary articles remained elevated. Further, the complete pass-through of high international oil prices is yet to be realised; fuel prices therefore displayed negative growth during Sep 07. Although rising global crude oil prices is being perceived as a downward risk, the recent announcement by the Government to freeze oil prices until Mar 08 by issuing Oil Bonds to OMCs, should help contain inflation expectations in the medium term. Money supply growth at 21% (for the week ended 28-Sep-07) also continued to remain far above the targeted range of 17.5%. The RBI has therefore raised the limit on its Market Stabilisation Scheme, in order to absorb some of the excess liquidity. Sustained capital inflows arising from ECBs and FII inflows into the equity markets have enhanced liquidity levels and resulted in a sharp increase in forex reserves thereby placing upward pressure on the rupee.

The rupee, which has now appreciated to less than 40/US\$ mark has adversely impacted export realisations – evident from the increasing divergence between export growth rates in dollar terms and export growth rates in rupee terms. Even in dollar terms, exports growth has slowed down, while non oil imports (a significant proportion of which are capital goods) have grown at a high rate, resulting in a widening of the trade deficit. Given the firm rupee, export volumes are likely to be affected in the coming months as well, leading to a further widening of the trade deficit and the Current Account Deficit. Although the RBI has taken measures to curb External Commercial Borrowings and has liberalised capital outflow norms, its impact on the rupee is expected to be limited. Given the strong economic fundamentals and the continued interest rate differential, we expect to continue to witness strong capital inflows.

Dun & Bradstreet's Economy Forecast

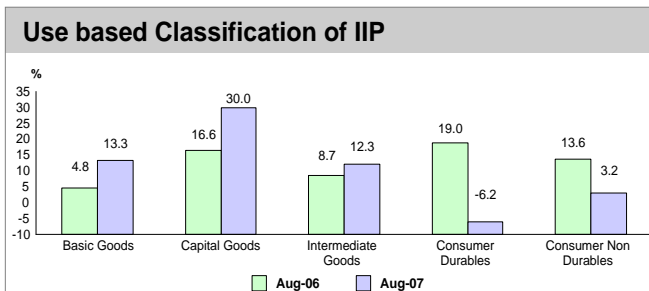
	FORECAST	ACTUALS	
		Latest Period	Previous Month
W.P.I	3.4%-3.6%(Oct-07)	3.31%(Sept-07)	3.97%(Aug-07)
IIP Growth	10.5%-11%(Sept-07)	10.7%(Aug-07)	7.5%(July-07)
91-day-T-Bills	6.7%-6.9%(Oct-07)	6.79%(Sept-07)	6.4%(Aug-07)
INR/US\$	39.4-39.6(Oct-07)	40.34(Sept-07)	40.82(Aug-07)

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

Real Economy

Investment activity remains high

Index of industrial production (IIP), after slowing down to record single digit growth in the preceding two months, bounced back to touch a double-digit growth of 10.7% in Aug 07. Mining and electricity sectors witnessed significant growth of 17% and 9.2% respectively, in Aug 07. The strong upsurge in the mining sector is partly attributed to the low base of the previous year – mining output had declined by 1.7% in Aug 06. Manufacturing sector registered a growth rate of 10.4% in Aug 07 as against 7.9% in the previous month. Sectors such as Wood and Wood products, Rubber, plastic, petrochemicals and coal products, Basic chemicals & chemical products, Basic metal and Alloy industries and Machinery & equipment recorded impressive growth rates and contributed almost 58% to the overall industrial production in Aug 07.



Source: CSO

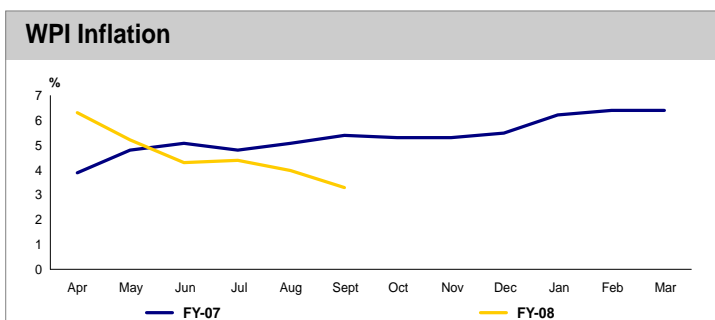
As per the use-based classification, capital goods sector grew by 30% in Aug 07, driven by a continued step-up in investment activity. The sustained robust expansion of capital goods sector reflects substantial capacity additions across industries. The total outstanding investments in the manufacturing sector as of Sep 07 stood at Rs 13,861.8 bn, which denotes an increase of 32.3% over the year-ago level. On the other hand, a slow down in consumption demand is indicated in the meagre 0.5% growth witnessed by the consumer goods segment in Aug 07 (as against 15% in Aug 06). The impact of high interest rates was reflected in the consumer durables sector, wherein production declined by 6.2% in Aug 07 as against a growth of 19% in Aug 06.

Industrial production is expected to maintain its growth momentum in Sep 07. Demand for consumer goods owing to the festive season will provide some support to overall IIP. We expect growth in industrial production (IIP) to be within the range of 10.5-11% in Sep 07.

Price Scenario

Prices of Primary articles remain elevated

Inflation, as measured by the Wholesale Price Index moderated to 3.26% for the week ended 29-Sep-07. This could be partly attributed to the high base of the previous year (wherein the inflation rate for the corresponding period was 5.4%). Inflation rate of Manufactured products marginally declined to an average of 4.21% in Sep 07 from 4.37% in the previous month. Amongst manufactured commodities, the sharp decline in sugar prices by as much as 15% has been able to nullify to some extent the impact of high prices of edible oils and oil cakes - which have been increasing at double-digit rates. High capacity utilization in the cement sector and continued demand from the construction sector stoked cement prices to an average of 11% in Sep 07.



Source: Ministry of Commerce

Although there was a moderation in the inflation rate of Primary articles in September, it continued to rule above 6%. Within the Primary articles group, inflation rate of Food articles averaged to 5% in Sep 07. The Non-Food articles group has also played a major role in driving the prices of Primary articles. Prices of Non-Food articles increased at a rate of 12.6% in Sep 07 and contributed almost 23% to the overall inflation. The pressure on prices of Primary articles reflects bottlenecks in domestic supply as well as global pressures on the prices of many commodities.

Although the recent announcement by the Government to freeze oil prices by issuing oil bonds would help contain inflation expectations, prices of Primary articles remain a concern. Price pressures on food items owing to the festive demand and the rise in prices of certain manufactured items are likely to keep headline inflation biased upwards for the next few weeks. We expect the WPI Inflation to average at around 3.4-3.6% during the month of Oct 07.

Money & Finance

Strong foreign fund inflows buoys stock market sentiment

In accordance with the monetary tightening measures taken by the RBI, the Central Government raised the limit on the Market Stabilisation Scheme (MSS) bonds to Rs 2,000 bn (from the existing limit of Rs 1,500 bn). This move is expected to help the RBI to absorb excess liquidity in the banking system. As on 28-Sep-07, growth in Money Supply was 21% as against 19% during the corresponding period of previous year. This is much higher than the RBI target of 17.5%.

The 50 basis points reduction in the US benchmark interest rates buoyed the sentiment in the domestic stock market, leading the Sensex to touch new highs.

Interest rate cuts by the US Federal Reserve have further widened the interest rate differential between India and the US. Inflows of foreign funds are therefore likely to remain strong as investors may take advantage of interest rate arbitrage opportunities. In Sep 07, the domestic stock market witnessed net FII inflows (in equities) of US\$ 3.96 bn, as against outflows of US\$ 1.92 bn in the previous month. Net FII inflows in equities surged to US\$ 10.75 bn during H1 FY08, as compared with US\$ 5.5 bn during the whole of FY07. This robust inflow of foreign funds could hamper the RBI's measures to tighten liquidity conditions. Call rates, though remained largely stable at 6% level; the outflow of cash for quarterly tax payments during end of the month, led call rates to surge only marginally. The 15-91 days treasury bills yield remained in the range of 6.2-7.1% in Sep 07. In view of the Fed rate cut, the international interest rate scenario and the current domestic economic fundamentals, we expect domestic interest rates to stabilize soon. We expect 15-91 day T-bills to be in the range of 6.7-6.9% in Oct 07.

Monetary Indicators				
	FY07	Jul 07	Aug 07	Sep 07
M3*	21.3	21.7	20.0	21.0
Bank Credit*	28.0	23.2	22.8	21.9
Non Food Credit*	28.4	23.9	23.2	22.1
Prime Lending Rate** (%)	12.5	13.3	13.3	13.3
5 year G-secYield (%)	7.9	7.4	7.8	7.7
Inflation (%)	5.4	4.4	3.9	3.3

* Figures are percentage y-o-y growth ** maximum PLR
Source: RBI

External Sector

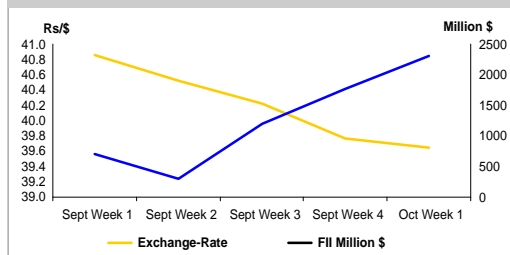
Rupee falls below the 40/US\$ mark

The impact of the rupee appreciation continues to manifest itself in export realisations and the overall trade deficit. Growth in exports in dollar terms slowed down to 18.9% in Aug-07 as compared with 25% in Aug-06. In rupee terms, exports grew by a meagre 4.3% (as against 32.9% in Aug 06). At the same time, imports grew by 32.6% (as compared with 18.7% in the corresponding month last year) driven by a 39.6% increase in non-oil imports – possibly a reflection of the continued high demand for capital goods. As a result, the trade deficit widened to US\$ 32.5 bn during the Apr-Aug 07 period as compared to US\$ 19.9 bn during Apr-Aug 06.

However, despite an expanding merchandise trade deficit, there was only a marginal increase in the current account deficit (CAD) for Q1 FY08 to US\$ 4.7 bn. A high net invisibles surplus emanating from high NRI remittances and software export revenues have helped contain the increase in the CAD. Net capital inflows, arising primarily from External Commercial Borrowings and equity inflows from FIIs, remained high – at US\$ 15.3 bn. Strong capital inflows have led to a sharp increase in foreign exchange reserves to US\$ 251.3 bn (as of 5-Oct-07), generating upward pressure on the rupee. The rupee appreciated by almost 9% since the start of this fiscal. Although the RBI has liberalised capital outflow norms, its impact on the rupee is expected to be limited in the near-term.

With the rupee expected to remain firm and an expected marginal slowdown in global growth, export volumes are likely to be affected in the coming months, leading to a widening of the trade deficit and CAD. Further, with rising international crude oil prices, oil imports are also likely to firm up. While cheaper imports, would help curb inflationary pressures, they may also exert competitive pressures on the domestic industry. Given the strong economic fundamentals, the interest rate differential, the bullish sentiment in the stock market, and the huge capital inflows, we expect the rupee to continue to remain strong and be in the range of 39.4-39.6 during the month of Oct 07.

Rupee continues to appreciate



Source: RBI; SEBI

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

Dun & Bradstreet Information Services India Pvt. Ltd., ICC Chambers, Saki Vihar Road, Powai, Mumbai 400 072

Tel: 91-22-28574190 / 92 / 94 Fax: 91-22-28572060 Email: D&BEconomyObserver@mail.dnb.co.in www.dnb.com