



Decide with Confidence

Dun & Bradstreet

ECONOMY OBSERVER

Issue 18 | October 2008

Contents

[View from the top](#)

Page 1

[Real Economy](#)

[Price Scenario](#)

Page 2

[Money & Finance](#)

[External Sector](#)

Page 3

View from the top

The global financial turmoil further intensified during the month of September, with many leading financial institutions facing trouble, meltdown in the stock markets and tight liquidity conditions across the world. The crisis of confidence being witnessed across the world's financial markets is also reflected in the increased volatility in the Indian financial sector. Sentiments in the domestic equity markets were largely bearish during the period under review. Moreover, significant liquidity crunch has been experienced in the domestic banking system - as reflected by firming up of call rates and increased recourse to the LAF window by banks. In order to ease the tight liquidity conditions, RBI in a surprise move reduced Cash Reserve Ratio (CRR) by 150 basis points (effective 11-Oct-08) which is expected to inject Rs 600 bn in the cash starved banking system.

On the Inflation front, WPI receded from its above 12% level to touch 11.80% for the week ended 27-Sep-08. Although inflation has moderated, it is still in double digits and remains an area of concern. Moreover, the cut in CRR is likely to put upward pressure on the money supply thereby increasing inflationary expectations. Further, the estimated fall in overall production of kharif crops during FY09 as compared to FY08 might lead to increase in food grain prices. Thus upward risks to inflation still persist and so D&B does not expect RBI to cut interest rates in the near future. Nonetheless, liquidity management will remain a top most priority in the view of continued turbulence in the global financial markets and the risk of potential spillovers to the domestic financial sector.

The deepening global financial crisis coupled with subdued demand conditions and high inflation have adversely affected corporate sentiment, as is reflected from the decline of as much as 28% (y-o-y) in the D&B's Composite Business Optimism Index for Q4 2008. Further, the Industrial production has experienced significant slowdown; IIP grew by mere 1.27% (y-o-y) during Aug-08. Moreover, agriculture sector growth is also expected to witness moderation during the current fiscal as kharif crops production is estimated to fall during FY09 as compared to FY08. The moderation in growth of industrial production and agriculture production is expected to slowdown the growth momentum of the Indian economy in the short run. However, the survey conducted by D&B for the Business Optimism Index revealed that respondents from the capital goods sector were more optimistic regarding receiving new orders during Q4 2008; this might be an indication of expected better demand conditions over the long term.

Dun & Bradstreet's Macro Economic Forecasts

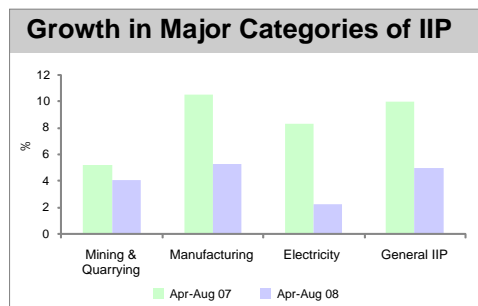
	FORECAST	ACTUALS	
		Latest Period	Previous Month
Inflation (W.P.I)	11.80%-12.00%(Oct-08)	12.02%(Sept-08)	12.37%(Aug-08)
IIP Growth	5.0%-6.0%(Sept-08)	1.27%(Aug-08)	7.37%(Jul-08)
15-91-day T-Bills	8.4%-8.6%(Oct-08)	8.62%(Sept-08)	8.93%(Aug-08)
INR/US\$	48.30-48.50(Oct-08)	45.56(Sept-08)	42.94(Aug-08)

All figures are monthly averages

Real Economy

IIP registers slowest pace of growth in last ten years

High interest rates coupled with subdued demand conditions in domestic as well as international markets have adversely impacted growth in industrial production – as was evident from mere 1.27% (y-o-y) growth registered by Index of Industrial Production (IIP) during Aug-08. This is the slowest pace of growth the index has registered since November 1998. The slowdown in IIP growth was more pronounced in the manufacturing sector, with as many as 10 out of 17 manufacturing categories registering negative growth. This in turn pulled down growth in the manufacturing sector to 1.15% during Aug-08 from 10.75% during Aug-07. The contribution of manufacturing sector to total IIP growth also declined significantly to 64.77% during Aug-08 from 89.17% during the previous month.



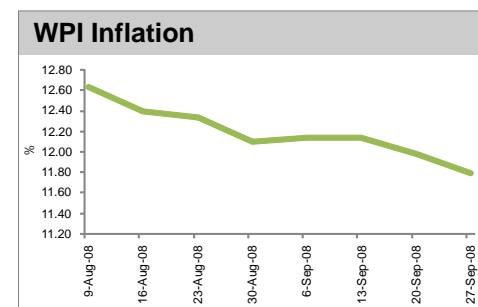
Source: CSO

Further, a substantial slowdown witnessed in sectors like 'cotton textiles', 'leather & fur products' and 'rubber, plastic petroleum & coal products' during Apr-Aug 08 has adversely impacted demand for intermediate goods. Growth in intermediate goods moderated substantially to an average of 0.77% during Apr-Aug 08 from 9.91% during Apr-Aug 07. The consumer goods sector posted growth rate of 5.06% during Aug-08 which stands lower than the growth registered in the first four months of the current fiscal. In fact, the low level of growth posted by consumer goods sector is despite the low base of Aug-07 (consumer goods sector grew by -0.04% during Aug-07) and the increased demand for consumer goods for festive season. Besides, the declining trend witnessed in capital goods sector is indicative of moderation in investment activity across industries in the short-term. This would have bearing on future industrial production and thereby on economic growth in the short-run. Given that demand conditions in domestic as well as international markets are subdued, D&B expects IIP to have grown within the 5.0-6.0% range during Sep-08.

Price Scenario

Inflation retreats from 12% level

Inflation, as measured by the WPI, receded from its above 12% level to touch 11.80% for the week ended 27-Sep-08. The moderation in the headline inflation during the month of Sep-08 can be largely attributed to a moderation in inflation of minerals oils, manufactured products and non-food articles. The headline inflation averaged at 12.02% (y-o-y) during Sep-08 as against 12.37% during Aug-08.



Source: CSO

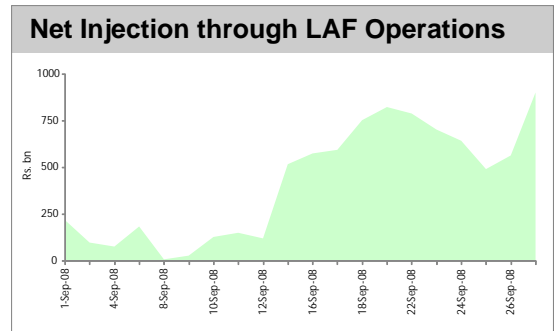
Within manufactured food products, prices of common salt increased surprisingly by 19.59% during Sep-08 as against 6.66% during Aug-08. Nonetheless, despite this significant increase, it contributed just 0.03% to the headline inflation due to its low weightage (0.02%). Further, prices of edible oils and oil cakes continued to witness moderation, pulling down inflation in manufactured food products to 13.70% during Sep-08. Besides manufactured foods products, prices of other manufacturing products like textiles, rubber & plastic products and machinery and machine tools witnessed significant moderation, causing inflation in manufactured products decline to 10.57% during Sep-08.

Within primary articles, inflation in non-food articles slowed down due to the significant moderation in inflation of oil seeds to 14.86% in Sep-08 from 18.05% in Aug-08. The moderation in prices of oil seeds can be possibly due to the better production prospects amidst the surge in area sown under oil seeds during the Kharif season of the current year. This coupled with receding global prices of edible oils (especially soya oil) are likely to ease inflationary pressure in edible oil segment in the near future. On the other hand, prices of food grains (particularly pulses) and fruits & vegetables witnessed significant increase during Sep-08. Further, late and deficient rains in some parts of the country coupled with floods in northern states have resulted in loss in area coverage under different kharif crops. The production of pulses might witness some moderation during 2008-09 as per the first advance estimates of agriculture production. This is likely to exert upward pressure on prices of pulses in the months to come. Prices of fruits & vegetables too are likely to remain elevated owing to the increased demand for festive season. D&B therefore expects WPI inflation to average between 11.80-12.00% during Oct-08.

Money & Finance

Indian Financial Sector jittery on global cues

Deepening of the global financial crisis, which resulted in liquidity crunch world-over, has increased volatility in the Indian financial markets as well. The BSE Sensex declined to 11,309 on 13-Oct-08, tumbling by almost 22% since 1-Sep-08. Credit crunch in the international markets and increased risk aversion by global investors has raised concerns over increase in FII outflows. The FII were net sellers in equity to the tune of US\$ 2.9 bn between 1-Sep-08 to 10-Oct-08. Further, the rupee depreciated significantly requiring RBI's intervention by way of dollar sale which in turn resulted into absorption of liquidity from the system. This along with advance tax payments by the corporates have added to the liquidity crunch in the system.



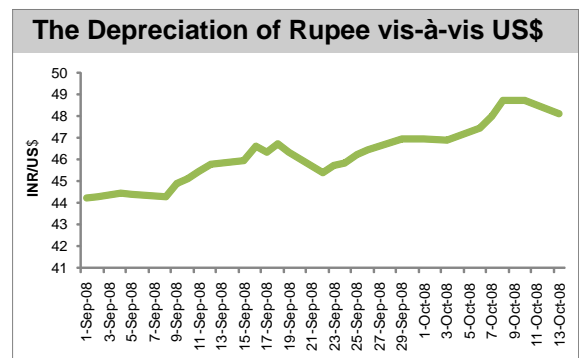
Source: RBI

Tight liquidity condition in the banking system is evident from firming up of call rates to 16.50% on 10-Oct-08 and increasing recourse to LAF window by banks. Net injection of funds through the LAF corridor mounted to Rs 8385.8 bn during Sep-08. In order to augment liquidity in the banking system RBI initiated market measures such as conducting second LAF operation on a daily basis, allowing banks to borrow more under the LAF by relaxing the SLR by 1%, etc. Further, in a surprise move RBI announced 150 bps cut in the CRR to 7.5% w.e.f. 11-Oct-08. Although this move is expected to provide some respite to the cash crunched banking system by injecting approximately Rs 600 bn, it is likely to put upward pressure on the money supply, which is growing at 19% (as on 26-Sep-08) above RBI's target of 16.5-17%. Further, the RBI canceled the scheduled bond auction worth Rs 100 bn which along with the CRR cut led yield on the ten-year benchmark gilt to ease to 7.79% on 10-Oct-08 as compared 8.49% on 29-Aug-08. 15-91 day Treasury bill yield were in the range of 8.35-8.85% for week ended 3-Oct-08. D&B expects 15-91 day T-Bills yields to average at around 8.4-8.6% in Oct-08.

External Sector

Rupee depreciation exerts upward pressure on import bill

The turmoil in the global financial markets and the resultant outflow of foreign capital led the rupee to depreciate as much as 9.5% between 1-Sep-08 to 10-Oct-08 and breach the psychological level of 49 per US Dollar in early trades on 10-Oct-08. In order to restrict losses in the domestic currency, the RBI intervened in the forex market at regular intervals. In addition, it announced market measures like the 50 basis points hike in interest rate ceilings of FCNR (B) and NR(E)RA deposits in order to increase inflow of private transfers.



Source: RBI

Although the recent depreciation in the rupee might augur well for exporters, it is likely to increase the overall imports bill. The overall imports rose significantly by 51.2% (y-o-y) to US\$ 29.95 bn during Aug-08. On the other hand, exports grew by 26.9% to US\$ 16.00 bn leading the trade deficit to surge to a record high of US\$ 13.94 bn during Aug-08. The upsurge in trade deficit might pose a risk of wider current account deficit (CAD) in the forthcoming quarters. In fact, India's CAD has already widened by almost 70.20% (y-o-y) to US\$ 10.72 bn for Q1 FY09 i.e. to 5.71% of GDP as compared with 3.58% of GDP during the year ago quarter. On capital account front, despite a significant increase in net FDI inflows, net capital inflows declined by 23.82% (y-o-y) to US\$ 13.21 bn during Q1 FY09 due to a huge outflow of foreign portfolio investment. In view of the current global liquidity crunch and growing risk aversion amongst foreign investors amidst the global financial crisis, the liberalisation of ECB policy and removal of restrictions on the issue of participatory notes by the FIIs is likely to have limited impact on inflow of foreign funds. However, these measures coupled with the RBI intervention in the forex market might restrict further depreciation of the rupee. D&B therefore expects the rupee to be in the range of 48.30-48.50 to a US\$ during Oct-08.

Please send your feedback to Yashika Singh, Head-Operations, 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