



Decide with Confidence

Dun & Bradstreet

ECONOMY OBSERVER

Issue 5 | September 2007

Contents

View from the top

Page 1

Real Economy

Price Scenario

Page 2

Money & Finance

External Sector

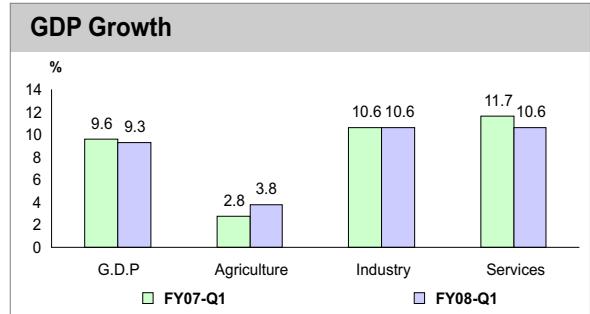
Page 3

View from the top

As per the latest available data, the Indian economy grew by an impressive 9.3% during the first quarter of the current fiscal. A closer look at the expenditure figures reveal that while gross capital formation has grown by 15.9%, growth in private final consumption expenditure has fallen to 5.6% - possibly a reflection of the impact of higher interest rates on consumer demand. Similarly, growth in the industrial sector has decelerated to 10.6%, with interest rate sensitive sectors witnessing a moderation in growth.

Irrespective of whether the recently released GDP estimates for Q1 FY08 are revised downwards, growth is likely to slowdown during the quarters to come. The lagged impact of the hike in interest rates during 2006, the recent appreciation of the rupee and a possible slowdown in global growth are all factors that could bring about a moderation in growth during this fiscal. Industrial production, as measured by the IIP, has also declined for the third month in a row during the current fiscal, pointing toward a possible further slowdown in industrial growth during Q2 FY08.

The US sub-prime mortgage crisis has resulted in a credit crunch in global financial markets, setting off uncertainty over global economic growth. Although India has little direct exposure to sub-prime asset backed securities, the crisis could impact us in the short term by way of an increasing level of risk aversion by global investors. During the month of Aug 07, at the time when several banks in the US and Europe had declared losses incurred in conjunction with sub-prime mortgages, FII were net sellers in domestic stock markets to the tune of US\$ 1.9 bn. Going forward, in the shorter run, as the extent of losses associated with the US sub-prime mortgage market continues to unravel, capital outflows could emerge as a downside risk. Given India's current economic stability, we expect sustained capital inflows once global liquidity returns to normal levels.



Source: CSO

Perceived risks to US growth prospects, a possible outcome of the crisis, does pose concern for India's growth outlook as several export-oriented companies, in particular, companies that cater to the BFSI segment could be impacted.

Dun & Bradstreet's Economy Forecast

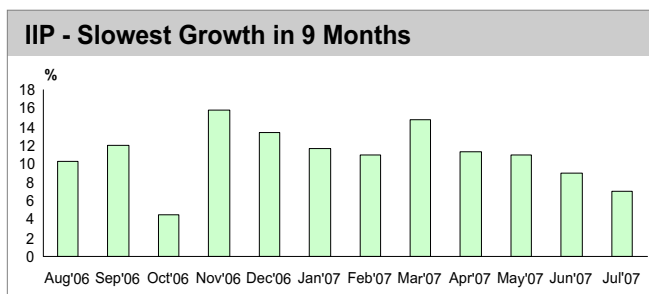
	FORECAST	ACTUALS	
		Latest Period	Previous Month
W.P.I	4-4.2%(Sep-07)	3.97%(Aug-07)	4.4%(Jul-07)
IIP Growth	8%(Aug-07)	7.1%(Jul-07)	9%(Jun-07)
91-day-T-Bills	7.3-7.5%(Sep-07)	7.1%(Aug-07)*	4.5%(Jul-07)*
INR/US\$	40.8-41(Sep-07)	40.82(Aug-07)	40.42(Jul-07)

all figures are monthly averages, (y-o-y) * end of the month

Real Economy

Growth momentum likely to slow down

Overall GDP grew by an impressive 9.3% during Q1 FY08, backed by the recovery in the agricultural sector and robust growth in the industrial and services sectors (both sectors grew by 10.6%). Agricultural sector growth seems to have picked up pace during the first quarter of the current fiscal; the sector grew by 3.8% reflecting a good rabi harvest during 2006. Although a growth rate of 10.6% in the industrial sector is robust, it represents a slowdown from the growth rate of 11.2% recorded during the previous quarter.



Source: CSO

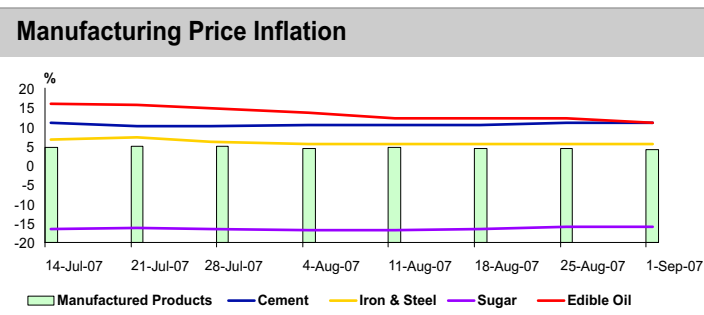
As forecasted by us, industrial production as measured by the IIP, has also declined for the third month in a row during the current fiscal, pointing toward a possible further slowdown in industrial growth during Q2 FY08. IIP grew by just 7.1% during the month of Jul 07 - the slowest growth in 9 months.

Manufacturing, with a weightage of about 80% in the IIP basket, has grown by 7.2% (against 14.3% in Jul 07), reflecting the lagged impact of high interest rates and the appreciation of the rupee. Lower consumer spending is evident from the decline in consumer durables production (-0.3% during Apr-Jul 07). GDP expenditure data also reveal private final consumption expenditure has slowed down to 5.6% during Q1 FY08. High interest rates could also be a factor behind the decline (-3% in Jul 07) in transport equipment and parts production index. A notable aspect of the IIP numbers is that the capital goods production, until now unaffected, has slowed down to 12.9% (Jul 07). The lower growth in industrial production should ease some of the pressure on the RBI for any monetary tightening in the near future. Given the lagged impact of high interest rates, the appreciation of the rupee and the moderation in industrial growth, GDP growth is likely to slowdown during the months to come. We expect the Index of Industrial Production to recover slightly to 8% during the month of Aug 07.

Price Scenario

Inflation falls to a 17 month low

Aided by a decline in prices of some manufactured products, inflation, as measured by the Wholesale Price Index has dipped to below 4% for the third week in a row. Inflation for the week ended 01-Sep-07 stands at 3.52%; the lowest rate in 17 months. The high base effect of the previous year has also played a role in moderating the inflation rate.



Source: Ministry of Commerce

After several weeks of high growth in the range of 9.5-10%, growth in primary articles prices has subdued to 8.6%. Manufacturing price inflation was at an average of 4.3% during the month of Aug 07, down from 4.8-5.3% levels witnessed during the earlier two months. However, while prices of edible oil and cement have been rising at double digit rates, sugar prices have been declining by as much as 15%, thereby downplaying the impact of high cement and edible oil prices on the Index. High capacity utilisation in some of these sectors has placed upward pressure on prices.

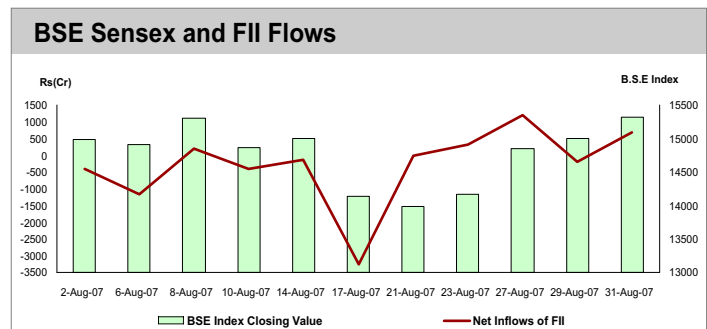
Consumer Price Inflation, as measured by the CPI, remained high during the month of Jul 07; the CPI (IW) stood at 6.5% while the CPI (AL) stood at 8.6% during the same month. Food products - which have a high weightage in the consumption basket, had witnessed a rise in prices during the month of Jul 07.

Given the good monsoons and the likely strong growth in the kharif crop and oilseeds & pulses production, some of the inflationary pressure on food items should ease in the coming months. Further, given expectations of a continued strong agricultural output and the high base effect, inflation is expected to remain around the 4% mark. High international commodity prices and high crude oil prices, however, persist as downside risks. We expect the WPI inflation rate to average at around 4-4.2% during the month of Sep 07.

Money & Finance

Credit offtake slows; money supply still high

Although several measures taken by the RBI have resulted in a moderation in credit offtake (23.1% as of 17-Aug-07), growth in money supply remains at 20% (as of 17-Aug-07) higher than the targeted rate of 17.5%. Strong foreign capital inflows have resulted in an increase in domestic liquidity, thus offsetting the impact of any monetary tightening measures taken by the RBI. This is evident from the 22.5% increase in net foreign exchange assets of the banking sector.



Source: BSE, SEBI

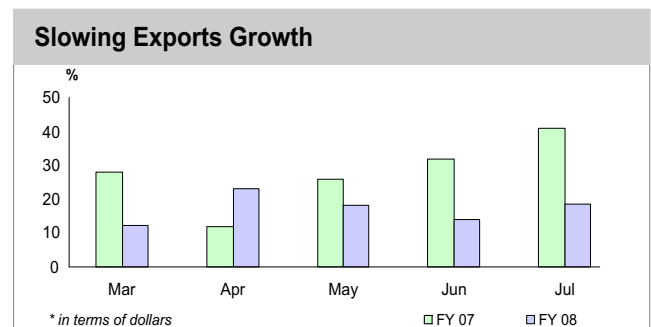
Call rates in the interbank money market, which had witnessed extreme volatility during the last few months, have also returned to 6% levels. 15-91 day Treasury bill yields have been hovering around the 6.6-6.9% range during the month of Aug 07. A notable trend witnessed in the money market during the last one month was that short-term, medium-term and long-term have all been in the range of 7.7-8%. This flatter yield curve could be due to expectations of a rise in short-term and medium-term rates resulting from monetary tightening.

Concerns over the US sub-prime crisis and the resultant decline in global liquidity levels, have, however, dampened the sentiment in global stock markets. Domestic stock markets too have witnessed FII outflows amounting to as much as US\$ 1.9 bn during the month of Aug 07. Although India does not have significant direct exposure to any sub-prime mortgage backed securities, increasing risk aversion and the unwinding of yen carry trade positions resulted in an outflow of FII funds. A further cut in the US Federal funds rate will widen the interest rate differential between Indian and US markets and may result in an increase in capital inflows. However, the extent to which such a policy move will increase capital flows to the domestic economy depends upon the risk appetite of global investors in the current scenario. In the short run we expect the 91 day T-Bill rates to average at around 7.3-7.5% during Sep 07.

External Sector

Growth in exports continues to slow down

Concerns over the impact of rupee appreciation vis-à-vis the US Dollar has further been exacerbated with the release of trade data for the month of Jul 07. Exports growth slowed down to 18.5% in Jul 07 in dollar terms as against 40.7% in the year-ago month. The impact of the weak dollar was more perceptible in export realisations in rupee terms; exports grew by just 3% in Jul 07 as against 50% in Jul 06. Meanwhile, imports during Jul 07 have also slowed down to 20% as against 42.8% in the year-ago month. With growth in exports slowing and imports expanding at a faster rate, the trade deficit widened to US\$ 25.6 bn during Apr-Jul 07 as compared to US\$ 16.7 bn in the year ago period. The performance of exports in the forthcoming months (festival season) will hold the key in determining if the export target of US\$160 bn for the current financial year would be met.



Source: RBI

Credit squeeze in the global markets owing to the US sub-prime crisis triggered a sell-off by foreign investors. FIIs were net sellers in equities to the tune of US\$ 1.9 bn in Aug 07. In effect, the INR declined to a two-month low of 41.36 on 16-Aug-07. The rupee however appreciated in the latter part of the month owing to expectations of a pick up in capital flows. Forex reserves in Aug 07 increased marginally by US\$ 3.5 bn (m-o-m) to US\$ 228.85 bn. Although the US sub-prime mortgage crisis continues to create ripples, the system seems to be adjusting to these shocks in an effective manner. The rupee would continue to remain strong and we expect the average value of rupee to be in the range of 40.80-41 for Sep 07.

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