



Decide with Confidence

Dun & Bradstreet

ECONOMY OBSERVER

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Contents

[View from the top](#)

Page 1

[Real Economy](#)

[Price Scenario](#)

Page 2

[Money & Finance](#)

[External Sector](#)

Page 3

[View from the top](#)

Inflation continued to moderate for the third week in a row partly due to a decline in international prices of crude oil and edible oils, following the improved supply side conditions. Fuel group inflation moderated to 17.08% during Aug-08 as against 17.21% during the previous month. However, despite a significant decline in global oil prices, with domestic prices of LPG, petrol and kerosene being regulated; it would take some time for inflation in fuel group to moderate substantially. Though the Wholesale Price Index (for the week ended 30-Aug-08) is higher than that compared to the previous week, the rate of inflation has fallen. This is largely because the proportionate increase in the index measured week-on-week basis is less than what it was in the previous year. Going forward, D&B expects inflation to remain in double digits till December 2008.

Further, high input costs coupled with the rising interest rates have adversely impacted the growth momentum as is evident from the moderation in GDP growth to 7.92% in Q1 FY09. Further, a decline in growth of Gross Fixed Capital Formation (GFCF) is a key concern as it will have a bearing on industrial production in the future. As such, with a fall in investment demand, capital goods sector has already slowed down registering a growth of 11.51% during Apr-Jul 08 as against 19.88% during Apr-Jul 07. This resulted in further moderation in the growth of industrial production, which registered an average growth of 5.7% during Apr-Jul 08 period vis-à-vis 9.78% during Apr-Jul 07. Nonetheless, given that inflation continues to be double digit and growth in money supply and bank credit remains well above the RBI's target, tight monetary policy is expected to continue, despite slowdown in growth momentum.

On the external front, a sharp surge in the oil imports bill on account of high international crude oil prices, caused the trade deficit to widen to US\$ 10.79 bn in Jul-08. However, as the price of international crude oil which had peaked in mid-Jul, has begun to recede, one could expect some moderation in the growth in value of oil imports. However, the weakening rupee – which depreciated by almost 8% vis-à-vis US Dollar between 1-Aug-08 to 12-Sep-08 period – is likely to limit the positive impact of the fall in international commodity prices like crude oil on trade deficit.

Dun & Bradstreet's Macro Economic Forecasts

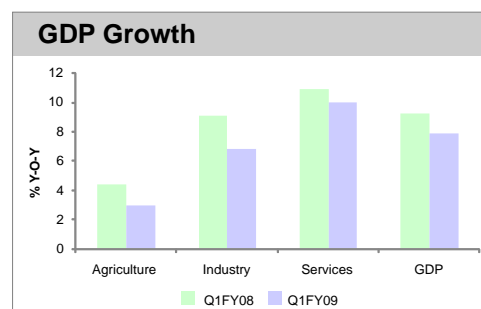
	FORECAST	ACTUALS	
		Latest Period	Previous Month
Inflation (W.P.I)	12.00%-12.20%(Sep-08)	12.39%(Aug-08)	12.12%(Jul-08)
IIP Growth	6.00%-7.00%(Aug-08)	7.06%(Jul-08)	5.44%(Jun-08)
15-91-day T-Bills	8.70%-8.90%(Sep-08)	8.93%(Aug-08)	8.68%(Jul-08)
INR/US\$	45.20-45.50(Sep-08)	42.94(Aug-08)	42.84(Jul-08)

All figures are monthly averages

Real Economy

GDP growth moderates to 7.92% in Q1 FY09

In line with D&B expectations, GDP registered near 8% growth during Q1 FY09. High interest rate regime consequent to the monetary tightening measures initiated by the RBI, subdued demand conditions and surging prices of raw materials adversely impacted growth momentum, pulling down growth in GDP for Q1 FY09 to 7.92% (y-o-y) as against 9.24% in Q1 FY08. Further, the moderation in agriculture sector growth to 2.96% in Q1 FY09 vis-à-vis 4.39% in Q1 FY08 can be largely attributed to a negative growth registered by production of pulses, oil seeds and sugarcane during the Rabi season of 2007-08 (ended in Jun-08).



Source: CSO

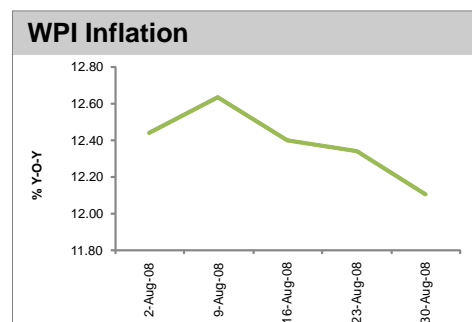
Although services sector continued to grow in double digits (10.03%) in Q1 FY09, growth in services sector stands lower as compared with Q1 FY08 (10.96%). The slowdown in growth was more pronounced in 'trade, hotels, transport & communication services' and 'financing, insurance, real estate & business services' possibly due to high fuel prices and rising interest rates.

Amongst industries, growth in manufacturing and electricity sectors witnessed a substantial decline to respectively 5.63% and 2.58% in Q1 FY09 (from 10.93% and 7.89% in Q1 FY08), pulling down growth in industrial sector to 6.86%. Further, growth in industrial production as measured by the Index of Industrial Production moderated to 7.06% during Jul-08 vis-à-vis 8.28% during Jul-07. However, it is higher than the growth witnessed during the previous three months of the current fiscal. Nevertheless, given the subdued demand conditions to some extent and high raw material prices, growth in industrial production is expected to remain moderate. We expect IIP to have grown within the 6-7% range during Aug-08.

Price Scenario

A decline in global oil prices leads to moderation in fuel group inflation

Inflation, as measured by the WPI, continued to moderate for the third consecutive week to 12.10% for the week ended 30-Aug-08. The moderation in inflation during the past three weeks can partly be attributed to the decline in international prices of crude oil and edible oils following the improved supply side conditions. Nonetheless, prices of food articles and manufactured products witnessed substantial increase, causing headline inflation to average at 12.39% during Aug-08.



Source: CSO

With a decline in global oil prices, inflation in industrial fuels like aviation turbine fuel, Naphtha, Lubricants and High speed diesel oil moderated slightly or remained unchanged; leading to a moderation in the fuel group inflation to 17.08% during Aug-08 as against 17.21% in the previous month.

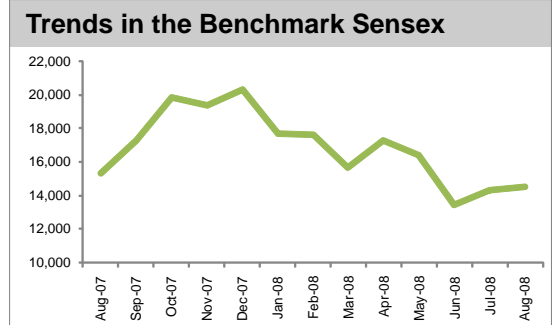
Within food articles, prices of 'fruits & vegetables' and 'egg, meat & fish' rose substantially, contributing almost 24.67% to the inflation in food articles during Aug-08. Further, prices of 'sugar, khandsari & gur' witnessed a significant increase during Aug-08 and contributed almost 16.21% to inflation in manufactured food products as against 3.84% during Jul-08. However, the sharp rise in prices of 'sugar, khandsari & gur' was partially offset by a decline in inflation of edible oils. With a decline in prices of imported edible oils (particularly, palm oil, soybean oil and sunflower oil) vis-à-vis the previous month domestic prices of edible oils continued to moderate for the third consecutive month and registered growth of 14.25% during Aug-08 as against 16.83% during Jul-08. Besides manufactured food products, prices of textiles experienced sharp increase, contributing 7% to the headline inflation.

Despite a significant decline in global oil prices, with domestic prices of LPG, petrol and kerosene being regulated; it would take some time for inflation in fuel group to moderate substantially. Further, prices of metallic minerals like iron ore still remain elevated, driving inflation in basic metals & alloys. In such a scenario, we expect WPI to average between 12.00-12.20% during Sep-08.

Money & Finance

Money supply continues to grow far above the RBI's target rate

Consequent to the RBI's monetary tightening measures, growth in money supply (M3) moderated slightly to 20.74% (as on 15-Aug-08) from 21.02% (as on 1-Aug-08). Nonetheless, it is still far above the RBI's target of 16.5-17% for FY09. Further, despite the surge in interest rates, growth in bank credit continued to remain high at 25.89% (as on 15-Aug-08). This can partly be attributed to the inability of investors to raise funds through the domestic stock markets which are currently in a bearish mode. During the first five months of the current fiscal, the benchmark Sensex index declined by almost 6.8% due to the FII outflows. The number of IPOs too, has fallen sharply due to less attractive premiums, limiting mobilisation to just Rs 15.93 bn during Q1 FY09 as compared with Rs 131.12 bn during the corresponding quarter of the previous fiscal.



Source: BSE

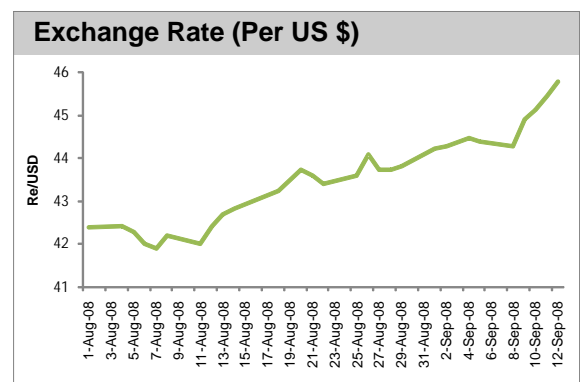
In the gilts market, buying interest by investors and government security purchases by banks boosted investor sentiment during Aug-08. Yield on the ten-year benchmark gilt declined by as much as 93 basis points to 8.47% (from 9.40% on 29-Jul-08) on 4-Sep-08. Call rates continued to remain elevated in the range of 9.00-9.80% during Aug-08, indicating the tight liquidity conditions in the banking system. 15-91 days Treasury bill yields were in the range of 8.85-9.25% for the week ended 29-Aug-08.

With a significant decline in global oil prices, inflation in industrial fuels is likely to witness some moderation, which will help in containing domestic inflationary pressures to some extent. However, given the high growth in money supply, the RBI is likely to continue with its liquidity tightening policy. We therefore expect 15-91 days Treasury bill yields to remain in the 8.70-8.90% range during Sep-08.

External Sector

Rupee breaches 45 per US Dollar mark

Oil imports bill registered a sharp increase in Jul-08 on account of high international crude oil prices. The oil-imports increased by as much as 69.3% (y-o-y) to US\$ 9.48 bn in Jul-08, taking total growth in imports to 48.1%. Even exports grew by an impressive 31.2% (y-o-y) in dollar terms during Jul-08 as compared to 23.5% during Jun-08. However, the growth in exports was lower than imports leading to a widening of the trade deficit to US\$ 10.79 bn during Jul-08. Infact, the trade deficit during Apr-Jul 08 has widened by almost 51% to US\$ 41.2 bn as compared to US\$ 27.3 bn during Apr-Jul 07.



Source: RBI

In the forex market, the rupee weakened vis-à-vis US Dollar and breached the 45 per US Dollar mark. The rupee depreciated by almost 8% to 45.77 on 12-Sep-08 as compared to the 42.37 on 1-Aug-08. Strengthening of the US dollar against major global currencies was one of the main reasons that weighed down the value of the rupee. Furthermore, sustained dollar demand from oil companies, corporates and importers coupled with a weak trend witnessed in the domestic stock market also put downward pressure on the rupee. The recent depreciation in the rupee might augur well for exporters, as it would improve export realisation in rupee terms. Nonetheless, it is likely to exert upward pressure on the overall imports bill, and may limit the extent of positive impact of declining international crude oil prices. With the strengthening US dollar, and sustained demand for dollar, we expect the rupee to be in range of 45.20-45.50 to a US\$ during Sep-08.

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

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