



Decide with Confidence

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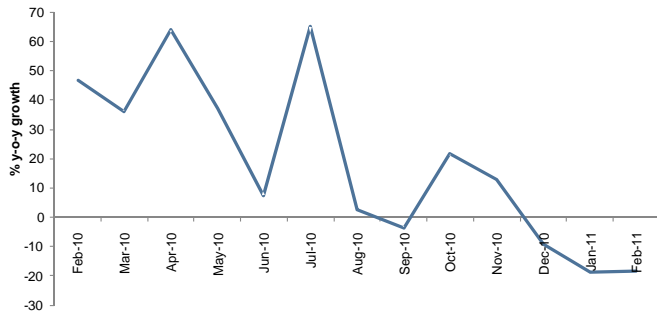
The spectre of high inflation continues to loom the Indian economy, with the WPI inflation for March touching 9%. More disconcertingly, households are now expecting inflation to be higher over the coming year; as per the RBI survey, households are expecting an inflation of 13.1% by the end of this year. The gravest risk herein is that higher inflation expectations, once entrenched, are difficult to eliminate. There is gloomier news on the industrial production front, with the slowdown in recent IIP growth lower than D&B's expectations. The moderation in industrial production though in part is a reflection of high statistical base and sluggishness in investment, does underscore a consolidation phase for industrial activity.

While the economic predicament in early 2011 no doubt raises concern, we believe that the underlying economic growth fundamentals still remain strong. Domestic demand growth continues to be buoyant, as evidenced in the rapid expansion of non-oil import demand. The disaggregated data on consumer durables suggest that the inherent consumer demand in the economy is holding up well. Moreover, the second order effect of the sharper-than-anticipated growth in agricultural production (8% in Q3 FY11) is expected to provide a further boost to consumer demand. D&B expects the growth in private final consumption expenditure (PFCE) to have improved to 8.2% during FY11 from around 7.4% during FY10. Going forward in FY12, improving consumer sentiment, optimistic employment scenario and rising income levels will maintain the growth momentum in PFCE. While strong consumer demand and growing exports will continue to support IIP growth in the coming months, its pace will however be tempered by high crude oil prices and rising interest rates.

While the persistence of crude oil prices at high levels will inevitably exert upward pressure on domestic inflation and put a dent on growth, we might see further pressure being eased off from the food inflation front- going by the healthy food grain production data and assuming a normal monsoon. Moreover, crude oil prices are likely to stabilise at current levels or recede during the latter part of FY12. This is likely to support the moderation in inflation during the course of the year, though manufactured products inflation is likely to remain high given that the higher input prices might be passed on to the consumer as the demand conditions improve. Also, the lagged impact of expected tightening of monetary policy would help to rein in the inflationary pressures during this period. The growth of the economy in the current fiscal will be particularly notable, as it will be unaided by government stimulus.



Capital goods continues its declining trend

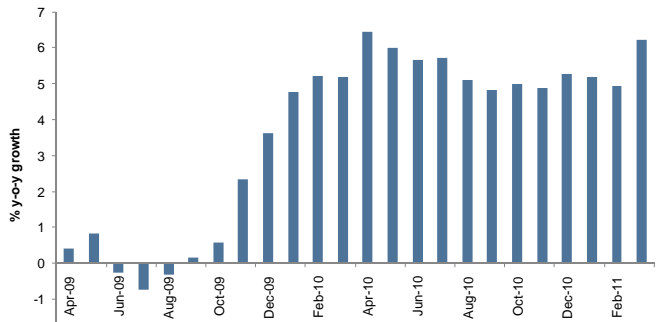


Source: CSO

Real Sector

- IIP grew by 3.6% (y-o-y) during Feb-11, thereby displaying a growth below 4% for four months in a row.
- IIP growth remained muted owing to the moderation in the manufacturing and mining sector which grew by 3.5% (y-o-y) and 0.6% respectively.
- Capital goods continued to contract for three months in a row, declining by 18.4% primarily owing to high base .
- Intermediate goods recorded a y-o-y rise of 8.4% during the month while basic goods moderated to 5.9%.
- Production in the consumer goods segment remained high as it grew by 11.1%, with the non-durables segment posting a positive growth of 6.1% for the second month in a row.

Inflation in Manufactured products on the rise

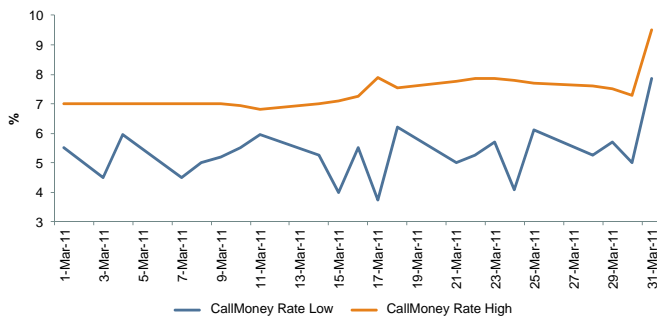


Source: Ministry of Commerce & Industry

Price Scenario

- The WPI Inflation further rose to 8.98% (y-o-y) during Mar-11 as compared to 8.31% during Feb-11 owing to increase in fuel group and manufactured products inflation.
- Inflation in manufactured products marched upwards and stood at 6.21% (y-o-y) during Mar-11 as compared to a growth of 4.94% during Feb-11.
- Inflation for primary food articles moderate to 9.47% during Mar-11 as compared to 10.65% during Feb-11, on account of lower prices of condiments & spices, tea, mutton, gram, moong, egg and masur and milk, arhar, wheat, barley and ragi.
- Fuel price inflation inched up to 12.92% during Mar-11 as compared to 11.49% during Feb-11, owing to elevated international crude oil prices.

Liquidity tightens

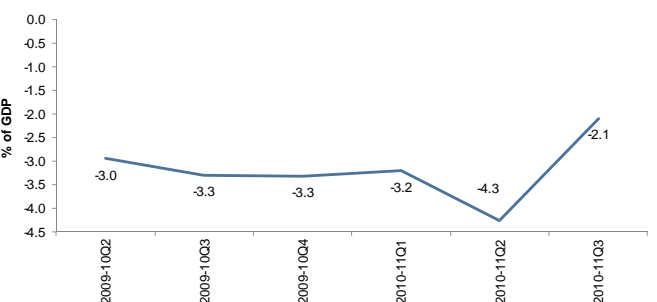


Source: RBI

Money & Finance

- RBI increases the repo and reverse repo rate under the liquidity adjustment facility (LAF) by 25 basis points each to 6.75% and 5.75% respectively.
- RBI extended liquidity management measures, currently set to expire on April 8, 2011. The additional liquidity support to scheduled commercial banks under the LAF to the extent of up to one per cent of their net demand and time liabilities (NDTL) is now extended up to May 6, 2011.
- Moreover, the second LAF (SLAF) will be conducted on a daily basis up to May 6, 2011.
- Bank credit to the industry continued to remain robust, growing by 20.4% as on 6-Mar-11 as compared to 18.4% during the year ago period. While personal loans recorded a growth of 14.8% as on 6-Mar-11, priority sector lending remained at 10.4%.

Current account balance improves



Source: RBI

External Sector

- India's exports rose by 49.7% (y-o-y) to US\$ 23.6 bn during Feb-11, while imports rose by 21.2% (y-o-y) to US\$ 31.7 bn leading to a trade deficit of US\$ 8.1 bn.
- The current account deficit moderated to US\$ 9.7 bn during the third quarter ended Dec-10 as against a deficit of US\$ 12.2 bn in the year ago period due to recovery in invisibles surplus.
- The capital account surplus increased to US\$ 14.9 bn during the third quarter ended Dec-10 as against a surplus of US\$ 14.6 bn in the year ago period due to higher net inflows under FII investments, external assistance, external commercial borrowings (ECBs) and banking capital.
- The net International Investment Position (IIP) resulting in net claims of non-residents to India increased by US\$ 18.2 bn to US\$ 221.1 bn as at end Dec-10 over the previous quarter.



Dun & Bradstreet's Macro Economic Forecasts

	Forecast	Latest Period	D&B's Comments
Inflation W.P.I	8.8%-9.0% Apr-11	8.98% Mar-11	WPI inflation will continue to remain elevated with the fuel and the manufacturing inflation posing an upward pressure. However, the easing of primary articles inflation owing to the healthy food grain production will provide some support to the headline inflation in the short term.
Inflation C.P.I (I.W)	8.3%-8.5% Mar-11	8.82% Feb-11	
Exchange Rate INR v/s US\$	44.30-44.50 Apr-11	44.99 Mar-11	The rupee is expected to remain strong during Apr-11, aided by an expected pick-up in capital inflows into India, especially portfolio inflows. The persistent rise in global crude oil prices and the expected increase in the merchandise trade could however curb the appreciation potential for the rupee.
I.I.P Growth	2.5%-3.5% Mar-11	3.56% Feb-11	High base effect would continue to dampen the IIP growth during the next few months. However, we are likely to witness more consolidation in industrial activity. Improving employment scenario and rising income levels would continue to support growth in the consumer goods segment.
GDP Growth	8.1 Q4 FY11	8.2 Q3 FY11	
15-91 days T-Bills	6.8%-7.0% Apr-11	6.81% Mar-11	Over the next few months, the pressure on liquidity may be eased off to a certain extent owing to increase in Government spending and improvement in deposit mobilisation. Moreover, the front-loading of Government spending during FY12 will also bring some respite. The expected improvement in liquidity may steepen the yield curve. However, rising of inflationary expectations and the lagged impact of policy rate hikes can exert pressure on G-sec yields for most part of FY12.
10 year G-Sec Yield	8.0%-8.2% Apr-11	8.18% Mar-11	
Bank Credit*	21.2%-21.4% Apr-11	21.4% Mar-11	While credit demand will typically slow down during April, and improvement in business environment and buoyant demand conditions may ensure that credit growth remains close to the RBI target of 20% during the rest of the fiscal.

All figures are monthly average

* Refers to End Period



Direct cash subsidy – Challenges for implementation

After extended debates, discussions and dialogues the Government finally announced its decision to move towards direct transfer of cash subsidy for kerosene and fertilisers for people living below the poverty line. This has been widely accepted as it raised hopes that this mechanism will reduce wastage and inefficiency, weed out black marketing and hoarding, and most importantly ensure that the subsidy reaches the targeted beneficiaries. The Government is also hopeful that the system of cash transfer will ensure more efficiency than the current system of indirect subsidy, which is plagued with leakages, in addition to bringing about a reduction in its subsidy bill through better targeting. While this has raised many expectations on one hand it has also raised questions regarding the feasibility of foolproof implementation in India where the problem lies in the inefficiency of the delivery mechanism and correct identification of the target population. However, this system of cash transfer of subsidies is not new and has been successfully implemented across a number of countries, the examples of which provides us with important lessons to be learned.

Several countries including Chile, Mexico, Indonesia, South Africa, Turkey, Morocco and New York have adopted the system of conditional cash transfer programs (CCTs). This program provides direct cash to the poor families on condition that they make verifiable investments in human capital, such as regular school attendance or use of basic nutrition and health care. Impact evaluations of such implemented programs has revealed many success stories; such programs have not only been effective in reaching the poor and improving their living conditions but also have led to important developments in the design, administration and governance of social policies. The largest and the most successful conditional cash transfer program is the Bolsa Família Program (BFP) in Brazil where a significant portion of the Brazilian society has been benefited.

While such success stories do raise hopes regarding the operation of such a system, there arises several questions regarding the success of implementation in India. The first and foremost challenge concerning the system of cash transfer in India is the proper identification of the intended beneficiaries i.e. BPL population. In Brazil, beneficiaries were identified through a thorough mechanism wherein information regarding household composition, income and living conditions (proxies) was collected through personal interviews of each family. Self-reported income is further validated against other proxy variables. This highlights the humongous task of identifying the correct beneficiaries, maintaining a single national database and regular monitoring, that the Government would face in the process of implementing the direct cash subsidy mechanism.

Brazil case study

The significance of the Bolsa Família Program in Brazil is that it covered more than 11.1 million beneficiary families i.e. almost 100% of Brazil's poor (as on 2007). The entire programme is administered by three institutions- While the programme is managed at the central level by The Ministry of Social Development (MDS), various aspects of the program is implemented by around 5,564 municipalities. Further, the Caixa Econômica Federal, a federal bank, has been contracted as the program's operating agent.

The entire system is managed through efficient targeting, disbursement and regular monitoring of the disbursed funds. The targeting of beneficiaries is done through a combination of methods i.e. geographic (federal and municipal) and household assessment based on per capita income. Family eligibility is determined by MDS based on household registry data collected locally and transmitted into a central database known as the Cadastro Único. The eligibility determination is centralized by MDS, which then establishes the monthly beneficiary payroll. According to the beneficiary list established by MDS, the Caixa distributes the electronic benefit cards (EBC) to the targeted beneficiaries. Caixa also assigns the registered individuals the unique Social Identification Number (NIS) and makes payments directly, crediting beneficiaries' electronic benefit cards (EBCs) on a monthly basis through its extensive banking network. There are overall 32,000 points (2,000 Caixa agencies, 9,000 lottery points, 2,000 banking correspondents) from where the beneficiaries can withdraw the money.

The second hurdle that lies before the Government is to devise the methodology to transfer the cash subsidy to the poor. While an extensive banking system in Brazil enabled the distribution of CCT programs, India still needs to develop a more inclusive banking system to incorporate the BPL people living in the rural regions and remote areas. According to RBI, only 40% of the population across the country have access to bank accounts. Thus, the Indian Government is relying heavily on Aadhaar, for implementation of the program. The implementation of Aadhaar, will facilitate hassle free opening of a bank account. The Government might then be able to directly transfer the cash to the Aadhaar-linked bank accounts of the beneficiaries. Moreover, even if such a process is devised the success of the cash transfer mechanism will depend on the time taken to cover the entire eligible population of India and the successful pan India implementation of the Aadhaar project. Another issue which raises concern is the effectiveness of the cash transfer when prices become volatile. As the market determined, prices of kerosene will be immediately impacted if global prices fluctuate, the poor would have to deal with the uncertain prices. The Government will also have to frequently administer and allocate the subsidy amounts which will pose significant administrative challenges.

Please send your feedback to Dr Arun Singh, Senior Economist.

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