

D&B ECONOMY OBSERVE



Decide with Confidence

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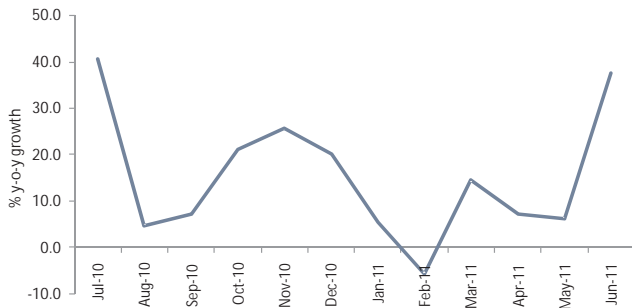
The prolonged uncertainties surrounding the European debt crisis and the US debt ceiling have led to the loss of confidence among financial market participants and other economic agents. While back in 2008, uncertainty came from the poor health of financial institutions, today fiscal concerns pose big challenges for policymakers. The public debt problems in the US culminated in the S&P's downgrading of US government debt, while the European debt crisis has flared up as pressure on markets in Italy, Spain and France intensified. Yields on Italian and Spanish ten-year bonds touched new heights in the last few weeks and there are concerns that the contagion could spread from debt to equity to credit and currency markets. These developments have cast a cloud over global economic stability in the coming years.

The notable deceleration in economic growth in advanced economies poses further risks. The US economy has been losing significant momentum over the past year and the growth during the first half of 2011 has been sluggish even after accounting for some transitory factors such as Japanese earthquake, oil price surge etc. Consumer confidence slumped in July, as did manufacturers' orders while job growth has been too slow to keep up with a growing labour force. Industrial production has dropped in every large euro-zone economy with Italy recording a decline in production for the second month. Risks to the world economy have exacerbated and the need of the hour is for policymakers to respond more adequately to address the public debt issues.

Increasing uncertainty about global growth has raised concerns on the domestic front. While the sovereign debt crisis in Euro Zone and slowdown in US economy will certainly have an impact on the demand for goods and services from these economies, diversification of India's export markets within Asia, Africa and Latin America should support export activity. D&B feels that the wider impact of the Euro-US debt crisis on the Indian economy may be limited. There are however other concerns that dampen the economy's growth prospects in the near term. Inflation is not showing signs of moderation and the manufacturing sector is facing margin pressure owing to rising input as well as borrowing costs and restrained demand. While monetary tightening may be required to rein in the demand side pressures, the importance of managing the supply side factors, which has been the key reason for driving up inflation, should not be neglected as this will only have a lasting impact in the fight to combat inflation.



Capital goods sector posts a sharp rise

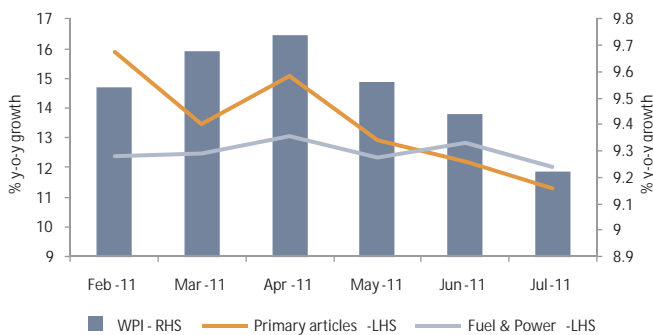


Source: CSO

Real Sector

- IIP records impressive growth of 8.8% during Jun-11 as against 5.9% in May-11.
- Manufacturing index increased by 10.0% (y-o-y) in Jun-11 as against 6.1% in May-11, while mining index moderated by 0.6% (y-o-y) in Jun-11 against 1.3% in May-11.
- Capital goods sector witnessed substantial increase of 37.7% in Jun-11 as against 6.1% in May-11.
- Consumer durables and Consumer non-durables grew at 1.0% (y-o-y) and 2.1% respectively with the overall growth in consumer goods being 1.6% during Jun-11.

WPI moderates owing to decline in primary and fuel group prices

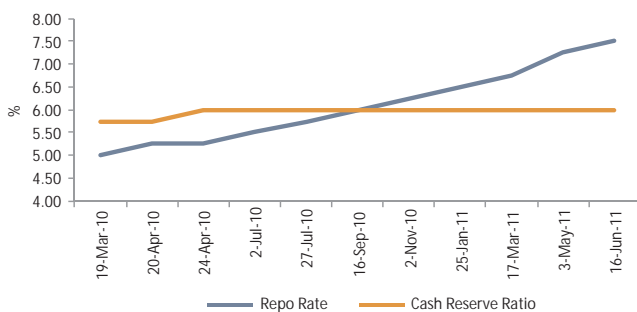


Source: Ministry of Commerce & Industry

Price Scenario

- The WPI headline inflation moderated to 9.2% (y-o-y) during Jul-11 compared to 9.4% during Jun-11.
- Primary articles recorded 11.3% (y-o-y) growth in Jul-11 as against 12.2% in Jun-11 due to moderation in food and non-food prices.
- Food prices moderated to 8.2% (y-o-y) in Jul-11 compared to 8.4% in Jun-11. Non-food prices grew by 15.5% (y-o-y) in Jul-11 compared to 18.6% in Jun-11.
- The inflation for Fuel and Power group stood at 12.0% (y-o-y) in Jul-11 compared to 12.9% in Jun-11.
- The inflation for manufactured products remains elevated at 7.5% in Jul-11 after remaining at 7.4% in Jun-11 and 5.9% in May-11.

Policy rate on a rise to curb inflation



Source: RBI

Money & Finance

- RBI increased the repo rate under the liquidity adjustment facility (LAF) by 50 basis points to 8.0%.
- The Marginal Standing Facility (MSF) rate, determined with a spread of 100 basis points above the repo rate, stands recalibrated at 9.0 %.
- Bank credit growth moderated to 19.3% (y-o-y) as on 29-Jul-11 as against 19.6% in the year ago period.
- Deposit growth increased to 18.1% (y-o-y) as on 29-Jul-11 as compared to 14.0% in corresponding period of the previous year.
- The BSE Sensex touched a 14-month-low of 16,857.91 on 09-Aug-11.

Exports continue to register strong growth



Source: Ministry of Commerce & industry

External Sector

- As per the provisional data, Indian exports rose by 81.8% (y-o-y) to US\$ 29.3 bn during Jul-11 while imports rose by 51.5% to US\$ 40.4 bn leading to a trade deficit of US\$ 11.1 bn.
- During Jun-11 oil imports grew at 30.1% and non oil imports grew by 47.8 % (y-o-y) during Jun-11.
- India's total foreign exchange reserves have increased to US\$ 311.8 bn as on 29-Jul-11 as compared to US\$ 297.5 bn as on 31-Mar-11.
- The rupee moved in the range of 43.9–45.3 per US\$ from 01-Jul-11 to 11-Aug-11.



Dun & Bradstreet's Macro Economic Forecasts

| | Forecast | Latest Period | D&B's Comments |
|-----------------------------------|-----------------------|------------------|---|
| Inflation W.P.I | 8.7%-8.9% Aug-11 | 9.22% Jul-11 | WPI inflation is expected to moderate from the current levels as primary articles, especially food prices continue to subside further. Moreover, aggressive rate hikes by the RBI is also expected to curb the demand pressures as well as the inflationary expectations going ahead. |
| Inflation C.P.I (I.W) | 8.4%-8.6% Jul-11 | 8.62% Jun-11 | |
| Exchange Rate INR v/s US\$ | 44.90-45.10 Aug-11 | 44.42 Jul-11 | Uncertainty posed by the developments in the US as well as in the Euro region might impact the foreign fund inflows to India, in turn causing a downward pressure to the rupee. The rupee is thus expected to remain volatile with a downward bias. |
| I.I.P Growth | 6.0%-7.0% Jul-11 | 8.75% Jun-11 | Moderation in investment activity owing to the rising interest rates and elevated input prices would keep the industrial production subdued during the near to medium term. Although, the high growth in exports will provide some support to the industrial production in the near term, such high growth levels are unlikely to sustain going ahead. Given that the RBI is expected to continue its monetary tightening as inflation still remains high, the consequent moderation in investment as well as consumption demand is expected to rein in the GDP growth levels going ahead. |
| GDP Growth | 7.7% Q1 FY12 | 7.8 Q4 FY11 | |
| 15-91 days T-Bills | 8.0%-8.2% Aug-11 | 8.04% Jul-11 | Persistent hike in interest rates is likely to keep the yields in the bond market elevated. However, risk aversion among investors owing to the prevailing uncertainty in the global economic environment might provide some downward pressure on bond yields. |
| 10 year G-Sec Yield | 8.3%-8.5% Aug-11 | 8.49% Jul-11 | |
| Bank Credit* | 18.5%-18.7% Aug-11 | 18.5 % Jul-11 | |

All figures are monthly average

* Refers to End Period



Commodity markets in India – An evaluation

The theory of portfolio diversification suggests that a well diversified portfolio enhances the Risk adjusted Returns of an investor. The alternatives available to the investor range from stocks, bonds, currencies to commodities. Commodities are the least explored option as awareness about them remains low. Although trading on commodities is uncommon in India, developed economies boast of well diversified commodity markets.

What led to the formation of commodity markets?

Like all other investment options, commodities are subject to uncertainties. The urge to hedge oneself against uncertainty led to commodity trading. Commodity instruments consist of bullion, crude oil, natural gas, ferrous and non ferrous metals, power, agricultural commodities etc. The risk in the form of global macro economic condition, availability, industrial demand, trade policy, currency movements, weather uncertainty etc is associated with commodities.

However, the presence of commodity markets has been subject to criticism. The two chief participants in commodity markets are the hedgers and the speculators. Commodity markets had been formed with an intention to cater to the agriculturists, industrialists and traders. While industrialists and traders would hedge their raw material risk, farmers could sell their produce on the platform. But awareness about commodity markets being low, presence of these participants remains negligible.

The Indian regulators are sensitive to inflationary pressures in the economy. The composition of speculators in the commodity markets and their role in driving up prices of essentials has raised a cause of concern. This school of thought views that the prices discovered on commodity exchanges are driven by speculators. For eg: The production of the Soybean crop in the year 2010-11 was 12.7 million MT while the traded volumes on Soybean on a prominent commodity platform during the same period was 45.7 million MT. This speculative trading renders volatility to the commodity prices with price increase being more likely than price decrease. This has drawn criticism against presence of commodity markets.

The second school of thought views commodity markets as merely a platform for price discovery through confluence of demand and supply. Trading in commodities in India is majorly active in three segments – Bullion, Crude oil and Agriculture.

Commodities traded in the bullion segment primarily comprise of Gold and Silver. Gold is demanded by industrialists, house holds and investors while supply is met through imports. Thus global economic conditions, interest rates, income levels and currency movements impact the price of commodity. Also, investors move towards Gold during recessions for its safe heaven status. Thus the price of the commodity is determined by multiple factors and not merely by speculative trading.

Crude oil is the second segment traded on commodity markets. The demand of the country is met through imports. Global demand depending on macro economic conditions, OPEC rules and regulations and currency movements determine the price of the commodity. India remains a price taker.

Agricultural commodities are the third segment traded on commodity markets. The agrarian sector of Indian economy is highly regulated by the Government. Government decisions regarding buffer stocks, minimum support price, export-import decisions and normality of monsoon influence the commodity prices of agricultural goods.

Arguments on futures trading fuelling inflation rather than facilitating price discovery led to a series of initiatives by the Government. Firstly, futures trading on essential commodities like wheat, rice, sugar, soya oil, rubber and potatoes witnessed ban. Secondly, a committee under Professor Abhijit Sen was set up to study the influence of futures trading on commodity prices.

The ban has not been successful in easing prices. Food price inflation stood at 9.90% as on 30-Jul-11. The Abhijit Sen committee reported that futures market in India is in nascent stage and hence no significant statistical evidence to infer could be drawn. Thus views of either school cannot be disregarded. The way ahead is to move with caution.

Commodity prices need to be assessed at periodic intervals to judge if futures trading is fueling price rise. Commodity trading is regulated by price circuits. For e.g. the price of soybean cannot vary more than 3% in either direction. These regulations need to be strictly adhered to. Finally, commodity markets should encourage hedger participation than speculative trading.