



Decide with Confidence

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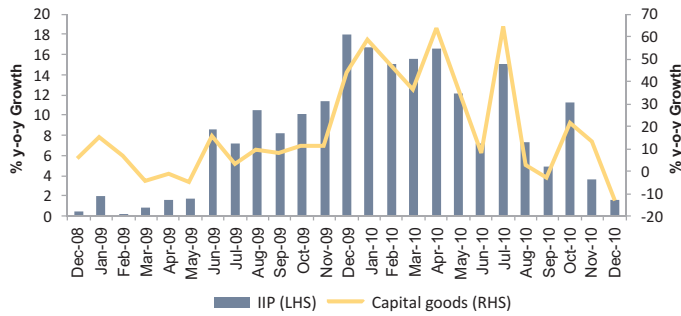
Confluence of factors such as high inflation, surging international crude oil prices, moderating IIP growth, high current account deficit, slump in the domestic stock market and low FDI have suddenly increased concerns on sustainability of India's growth momentum. While these factors do pose some downside risks to growth and require careful monitoring, it would be premature to raise any high alerts on the state of the economy at the current juncture. GDP growth, though expected to moderate during the second half of the current fiscal, will remain resilient drawing support from the domestic consumption and investment demand.

Domestic demand has been resilient and has shown signs of improvement in the past few quarters. Consistent performance of IIP for consumer durables, robust growth of Private Final Consumption Expenditure (PFCE) during H1 FY11, high corporate sales and sustained improvement in earnings does point towards buoyancy in demand. Even the investment scenario has witnessed improvement; during H1 FY11, banks/FIs sanctioned assistance for around 338 projects involving about Rs. 2,42,000 crore as compared to 251 projects worth Rs. 2,31,000 crore during the corresponding period of the previous year. Positive investment outlook, improvement in employment scenario, increasing wage levels and resilient external demand is expected to support economic activity going forward.

Unlike the last two fiscal years, the contribution from the government sector to GDP is expected to be limited during FY12, given the pressures on fiscal front. However, meeting the deficit target of 4.8% for FY12 articulated by the thirteenth finance commission would be difficult, especially in the current challenging times. We expect fiscal deficit to be slightly more than 5.0% during FY12. While fiscal consolidation is expected to top the budget agenda, it will be extremely important for the government to articulate a definitive reform plan especially in the agriculture and infrastructure sector which will be crucial for providing long term solutions to tackle inflation and ensure sustainability of growth. Improving agriculture productivity and removing bottlenecks in the food supply chain would be important. The focus on capital expenditure to address the growing infrastructure gap will also be crucial. While it would be challenging for the government to appropriate more funds in these directions, the budget must enhance the policy environment towards attracting private participation in these sectors. Even as the government targets fiscal consolidation, building enough fiscal space to tackle any untoward developments on inflation as well as growth front is imperative.



Volatility in capital goods renders IIP volatile

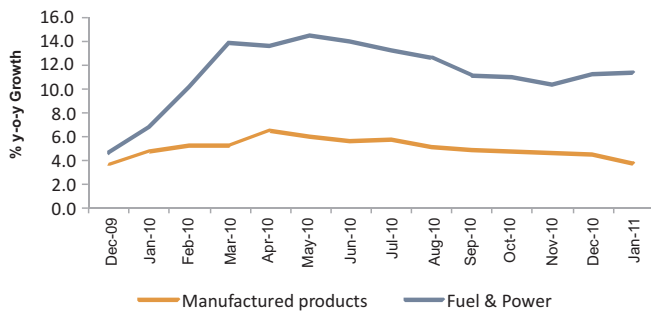


Source: CSO

Real Sector

- IIP grew by only 1.6% during Dec-10 primarily owing to the base effect. In fact the de-seasonalised IIP data indicate growth of 2.3% (m-o-m) during Dec-10 after a decline of 4.0% (m-o-m) during Nov-10.
- The IIP for Mining, Manufacturing and Electricity sectors for the month of Dec-10 grew by 3.8%, 1.0% and 6.0% respectively on a y-o-y basis.
- While Consumer non-durables continued to post negative growth for the second month in a row, Consumer durables grew by 18.5% (y-o-y) during Dec-10 after growing by 4.4% during Nov-10.
- The Capital goods registered a negative growth of 13.7% (y-o-y) during Dec-10 after growing by 12.8% (y-o-y) during Nov-10. However, the decline in growth can be attributed to the high base of the previous year, as the index value shows a increase of 10.5% on a m-o-m basis.

Rise in fuel prices poses risk to manufacturing group inflation

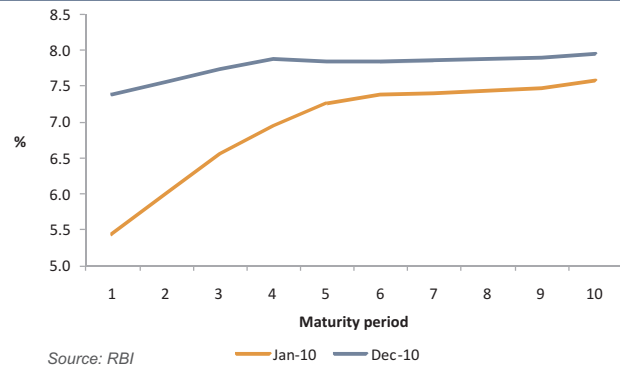


Source: Ministry of Commerce & Industry

Price Scenario

- The WPI inflation further moderated to 8.2% (y-o-y) during Jan-11 as compared to 8.4% during Dec-10 owing to a moderation in inflation for manufactured products.
- Inflation in manufactured products moderated to 3.8% (y-o-y) during Jan-11 as compared to a growth of 4.5% during Dec-10.
- Inflation for primary articles continues to remain elevated owing to high prices of food articles. Inflation in primary articles rose to 17.3% (y-o-y) during Jan-11 as compared to 16.5% during Dec-10.
- Inflation for food articles rose to 15.7% (y-o-y) during Jan-11 as compared to 13.6% during Dec-10.
- With surge in global oil prices, petrol prices rose by 27.4% (y-o-y) during Jan-11 as against 21.7% during Dec-10.

Yield curve flattens on liquidity concerns

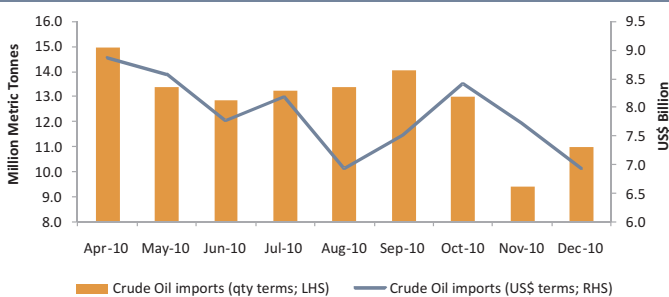


Source: RBI

Money & Finance

- The Bank Rate and the Cash Reserve Ratio (CRR) of SCBs kept unchanged at 6.0% in the third quarter Monetary policy review.
- The Repo and the Reverse Repo rates under the Liquidity Adjustment Facility (LAF) increased by 25 basis points each to 6.5% and 5.5% respectively with effect from 25-Jan-11.
- The additional liquidity support to SCBs under the LAF to the extent of up to 1% of their net demand and time liabilities (NDTL), currently set to expire on 28-Jan-11, has been extended up to 8-Apr-11. For any shortfall in maintenance of the SLR arising out of availment of this facility, banks may seek waiver of penal interest purely as an ad hoc measure.
- The second LAF (SLAF) will be conducted on a daily basis up to 8-Apr-11.
- The 30-share BSE Sensex slumped to a seven-month low of 17,508 on 09-Feb-11.

Trend in oil imports



Source: PPAC and Ministry of Commerce

External Sector

- India's exports rose by 36.4% (y-o-y) in Dec-10 to US\$ 22.5 bn, while imports declined by 11.1% (y-o-y) to US\$ 25.1 bn, recording a trade deficit of US\$ 2.6 bn during Dec-10.
- Oil imports, during Dec-10, recorded a decline of 16% (y-o-y) and stood at US\$ 6.93 bn.
- Non-oil imports, during Dec-10, decreased by 9% (y-o-y) and were estimated at US\$ 20.01 bn.
- International price for crude oil soared to US\$ 101.43 per barrel (ICE Brent) on 11-Feb-11.
- Rupee stood at 45.76 per US\$ on 11-Feb-11.



Dun & Bradstreet's Macro Economic Forecasts

	Forecast	Latest Period	D&B's Comments
Inflation W.P.I	7.7%-7.9% Feb-11	8.23% Jan-11	Although, inflation in primary article dropped to a seven week low, larger upside risks to inflation in the form of rising crude oil prices, which soared to US\$ 101.43/bbl (11-Feb-11), remains elevated. While food inflation has declined, rising inflation level in non-food articles raises concerns. Rising input prices also pose a risk to the manufacturing inflation going ahead. However, the headline inflation is expected to moderate to around 7.7%-7.9% during Feb-11 owing to high base.
Inflation C.P.I (I.W)	9.6%-9.8% Jan-11	9.47% Dec-10	
Exchange Rate INR v/s US\$	45.50-45.70 Feb-11	45.39 Jan-11	Increase in dollar demand owing to persistent rise in the global crude oil prices along with the uncertainty in global economic scenario, especially in the US and Euro Zone, are expected to exert downward pressure on the rupee. The rupee is expected to depreciate during Feb-11 as compared to the current levels.
I.I.P Growth	3.0%-4.0% Jan-11	1.55% Dec-10	High base effect would continue to dampen the IIP growth during the next few months. The number is expected to remain around 3.0-4.0% during Jan-11 and average at 8.1% for FY11. While resilient demand conditions in both domestic and external markets, infrastructure spending by government are likely to support the industrial activity going forward, high inflation and rising interest rates might act as a deterrent to growth.
GDP Growth	8.4 Q3 FY11	8.9 Q2 FY11	
15-91 days T-Bills	6.8%-7.0% Feb-11	6.80% Jan-11	Liquidity conditions are expected to improve on anticipated increase in government spending and gradually improving bank deposit, which in turn might ease some pressures on the long term yields. However, mounting inflation and elevated policy interest rates are likely to keep short-term bond yields at elevated levels. With domestic demand gathering strength and further improvement in the business environment, growth in bank credit is expected to remain upbeat in the near future.
10 year G-Sec Yield	8.0%-8.2% Feb-11	8.23% Jan-11	
Bank Credit*	23.2%-23.5% Feb-11	23.2% Jan-11	

All figures are monthly average

* Refers to End Period

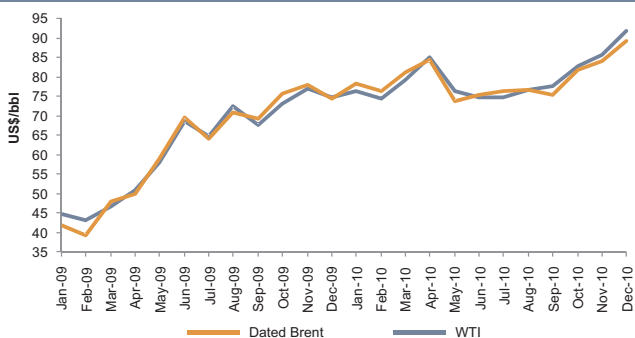


Surging global oil prices – key determinants

Global oil prices have witnessed significant volatility in the recent years. International crude oil prices, which surged to an all time high during mid-2008, plunged significantly towards end-2008 consequent to the slowdown. With concerns regarding global recession waning gradually, oil prices once again started moving northwards during 2009. This largely mirrored the improving business sentiment as well as economic revival and was widely anticipated. However, the sharp surge in global oil prices during last few months is distressing and has imparted cautiousness amongst policy makers worldwide. The ICE Brent price surged close to US\$ 100/bbl mark as on 4-Feb-11, significantly higher than US\$ 69.6/bbl price registered on 5-Feb-10. Price of dated Brent grew by almost 23% (y-o-y) to touch US\$ 91.8/bbl (average) during Dec-10 - the level last seen in Sep-08. The domestic oil prices as measured by the WPI for mineral oils also grew by almost 16.7% (y-o-y) during Jan-11 as against 15.8% during Dec-10.

Given that India imports almost 80% of its crude requirements, tracking fluctuations in global oil prices is warranted. It is imperative to see the key factors driving the current surge in global oil prices in order to gauge their movement in the coming months.

Soaring global oil prices



Source: IMF

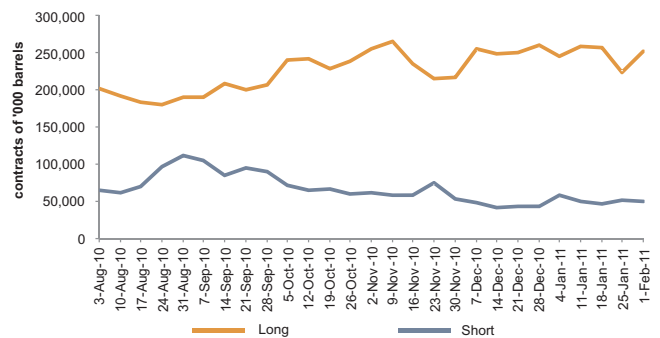
Factors contributing to the soaring global oil prices

The current surge in global oil prices in the face of high global inventories of crude oil is intriguing. Despite some reduction from the previous month, US commercial oil stocks remained at a surplus of 75 million barrel (mb) during Dec-10 - above the five year average; commercial oil inventories in Japan also rose by 9.1 mb in Nov-10. This, in fact, is an indication of a persistently well-supplied market and belies any supply side pressures on oil prices.

The upward pressures on the global crude oil prices are being exerted by the improving demand and speculative activities in the global oil markets. A slew of macroeconomic indicators corroborate that growth in emerging economies has remained robust during 2010. The US and Japan are also witnessing some improvement in private consumption consequent to stimulus measures. The expansion in global economic activity followed by the expectations of sustained improvement in the same led to

bullish market sentiment and a rise in investment flows into major commodity markets particularly crude oil, which in turn pushed global oil prices to higher level. The US Commodity Futures Trading Commission (CFTC) report reveals that net investment in WTI crude oil rose by 8.0% (m-o-m) during Dec-10 as against 3.2% in Nov-10.

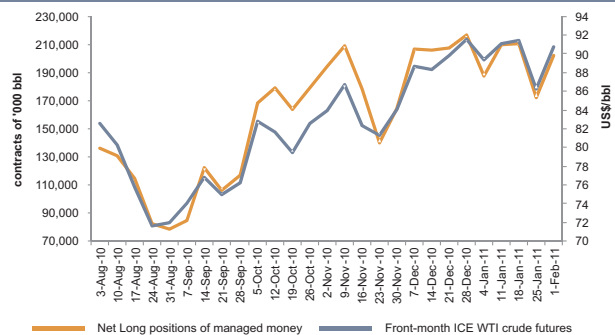
Speculation in crude oil



Note: 1. Data pertains to long and short positions of managed money on crude oil light sweet - NYMEX; 2. Commitments of traders are for futures and options combined; 3. Managed money category mentioned in the graph includes hedge fund, registered commodity trading advisor and a registered commodity pool operator
Source: US Commodity Futures Trading Commission (CFTC)

Moreover, speculation activity in the crude oil futures market, as reflected by the rise in net long positions of money managers, seems to have played a role in driving oil prices up. Net long positions of managed money in crude oil (on Nymex) increased to 201.9 mn bbl contracts as on 1-Feb-11, higher than 172.0 mn bbl contracts as on 25-Jan-11. The front-month WTI futures moved in tandem and recorded an increase of US\$ 4.6/bbl in a span of a week's time to US\$ 90.8/bbl (as on 1-Feb-11). This underscores the role of speculative activities in influencing crude oil price.

Crude futures prices move in tandem with the change in net long positions



Source: CFTC and ICE

Future Outlook

The future course of global oil prices largely hinges on the nature of economic recovery in the US, further developments with regard to sovereign debt issue and concerns of overheating arising in some EMEs. Further, weaker-than expected growth in oil demand during 2011, surplus stock of crude oil and political tensions in Egypt might impact global oil prices in the medium term.

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