D&B ECONOMY OBSERVER

Decide with Confidence

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The uncertainty regarding the global as well as the domestic growth prospects which started during early 2011 continued to prevail as the year 2012 started. The growth in most advanced economies remains fragile and there are risks of another economic recession and financial crisis in some regions in the advanced economies. However, the pace with which the emerging markets, including India, were impacted from this global economic turmoil was not anticipated.

The transmission of the global economic crisis in the Indian economy have been felt in the recent period in the form of widening of the current account deficit, outflow of foreign funds, volatility in the stock markets and the sharp depreciation of the rupee. However, the pace of growth of the Indian economy had already been restrained by various domestic factors. Sticky WPI inflation hovering above 8.0% since Jan-10, 375 basis point hike in repo rate by the RBI, slide in the investment as well as the savings rate, the spate of corruption scandals, political gridlock on economic reforms and regulatory bottlenecks limiting investment have dampened India's growth.

To add to the current uncertainty, the volatility and the revision in the various economic data sets has imposed ambiguity in assessing the economic scenario. There has been a significant downward revision in the exports data reported by the government. The sharp contraction in the industrial production data in Oct-11 has been followed by a surge in the IIP data for Nov-11. More confounding is the double digit growth in the consumer goods segment at a time when moderation in demand was widely anticipated.

At this juncture the role of the government assumes significance. While some of the policy measures undertaken by the Government recently are commendable, a more pro-active rather than a reactive approach towards initiation of reforms and a stronger resolve on key legislations is warranted. Moreover, the government balance sheet continues to weaken given the moderation in growth of tax revenues and higher subsidies. The rising fiscal deficit has been entwined with the rise in the current account deficit leading to fears of being embroiled in the twin deficit trap which had led to the balance of payment crisis during 1991. The current account deficit which has touched 3.6% during H1 FY12 is likely to remain above 3% during FY12. The Centre's fiscal deficit which has already touched 6.7% of GDP during the first half of FY12 is likely to be more than 6.0% for FY12. In this scenario to what extent can the government step in to boost growth as private investment activity also remains muted raises concern.

Real Sector

□ IIP grew by 5.9% (y-o-y) during Nov-11 as against a revised 4.7% decline during Oct-11. IIP grew by 3.8% during Apr-Nov FY12 as compared to a growth of 8.4% during the same period previous year.

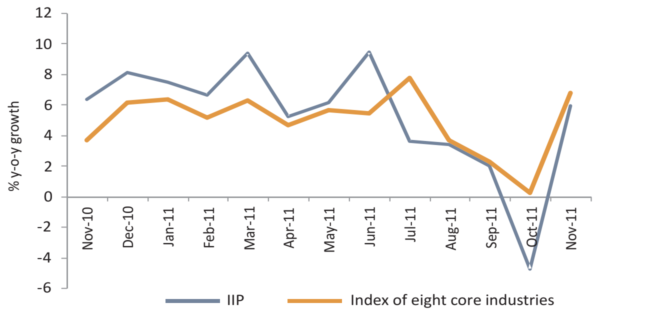
□ The manufacturing sector grew by 6.6% (y-o-y) during Nov-11 after declining by 5.7% during Oct-11. However, the mining sector contracted for the fourth consecutive month by 4.4% (y-o-y) during Nov-11.

□ Capital goods declined for the third consecutive month by 4.6% (y-o-y) during Nov-11 after recording a decline of 26.5% during Oct-11.

□ Consumer goods sector grew by 13.1% (y-o-y) led by 11.2% growth in consumer durables and 14.8% growth in consumer non-durables, partly owing to base effect.

□ Index for eight core industries grew by 6.8% (y-o-y) during Nov-11 as compared to a growth of 0.3% during Oct-11.

IIP and infrastructure index remains volatile



Source: CSO and Ministry of Commerce and Industry

Price Scenario

□ WPI inflation moderated to 7.5% (y-o-y) during Dec-11 from 9.1% during Nov-11.

□ Primary articles grew by 3.1% (y-o-y) during Dec-11 as against 8.5% during Nov-11.

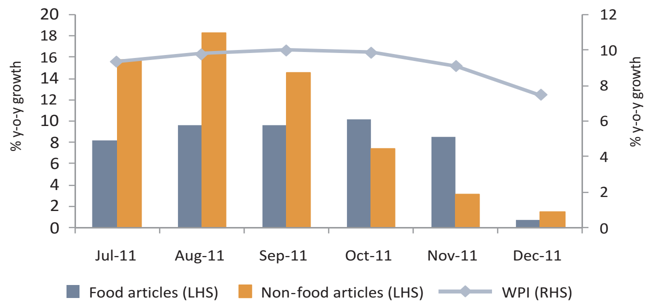
□ Food articles inflation moderated significantly to 0.7% (y-o-y) during Dec-11 as compared to 8.5% during Nov-11 led by decline in inflation in vegetables and moderation in cereals inflation.

□ Inflation in non food articles slowed down to 1.5% (y-o-y) during Dec-11 as against a growth of 3.2% during Nov-11 on the back of fall in inflation of fibres and oilseeds.

□ Fuel group index also slightly moderated to 14.9% (y-o-y) during Dec-11 from 15.5% during Nov-11.

□ Manufactured products remained elevated at 7.4% (y-o-y) during Dec-11. During Nov-11 it stood at 7.7%.

WPI eases led by moderation in primary articles inflation



Source: Ministry of Commerce and Industry

Money & Finance

□ RBI kept the policy repo rate under liquidity adjustment facility unchanged at 8.50%. Consequently, the reverse repo stands at 7.50% and the marginal standing facility rate stands at 9.50%.

□ Bank credit increased by 16.0% (y-o-y) as on 30-Dec-11 as against a growth of 24.6% during the same period in the previous year.

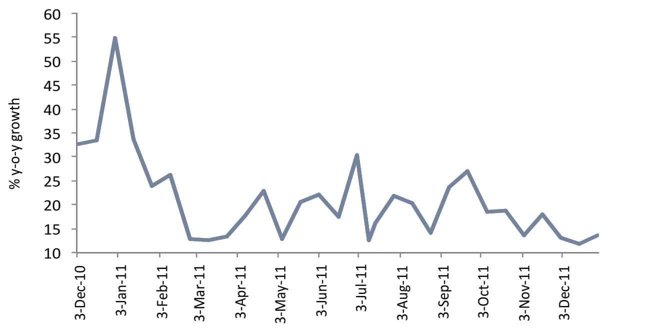
□ Bank credit to agriculture moderated to 7.3% (y-o-y) during Nov-11 as compared to 20.0% during Nov-10.

□ Bank credit to industries increased by 20.9% (y-o-y) during Nov-11 as against 27.0% during Nov-10.

□ Bank credit to services sector grew by 16.9% (y-o-y) during Nov-11 as compared to a growth of 22.5% during Nov-10.

□ Personal loans registered a growth of 13.4% (y-o-y) during Nov-11 as compared to 12.6% during Nov-10.

Credit offtake moderates on rising borrowing costs



Source: RBI

External Sector

□ India's exports during Nov-11 grew by 3.9% (y-o-y) to US$ 22.3 bn while imports grew by 24.5% to US$ 35.9 bn.

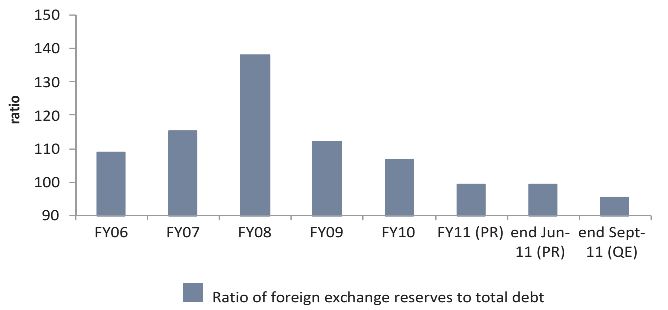
□ While the trade deficit for the month of Nov-11 stood at US$ 13.6 bn, the cumulative trade deficit for the period Apr-Nov FY12 stood at US$ 116.8 bn higher than the deficit of US$ 93.0 bn during Apr-Nov FY11.

□ The current account deficit stood at US$ 16.9 bn in Q2 FY12 as compared to US$ 15.8 bn in Q1 FY12 and US$ 16.9 in Q2 of FY11. As a proportion of GDP, CAD stood at 3.6% during H1 FY12 - marginally lower than 3.7% during H1 FY11.

□ The net inflows under the financial account during Q2 FY12 stood at US$ 17.9 bn lower than Q2 FY11 mainly on account of FII outflows.

□ While India's total external debt stock stood at US$ 326.6 billion at end Sept-11, the foreign exchange reserves stood at US$ 311.5 bn during the same period.

Forex cover to external debt falls



Source: RBI

Dun & Bradstreet's Macro Economic Forecasts

	Forecast	Latest Period	D&B's Comments
Inflation W.P.I	6.9%-7.1% Jan-12	7.47% Dec-11	The moderation witnessed in the WPI inflation is expected to continue during the month of Jan-11 as well primarily due to the seasonal decline in the prices of fruits and vegetables. Nonetheless, the upward risks to WPI inflation still persist as manufactured articles as well as fuel group inflation remains elevated. Thus, the RBI is unlikely to cut policy rate before April-2012.
Inflation C.P.I (I.W)	8.1%-8.3% Dec-11	9.34% Nov-11	
Exchange Rate INR v/s US$	51.80-52.00 Jan-12	52.67 Dec-11	Rupee is expected to remain weak during Jan-11 as dollar strengthens owing to the debt crisis in the euro region and high oil importer led dollar demand. Nonetheless, dollar inflows in the Indian debt market is expected to provide some upward pressure to the rupee as the limits on the amount of bonds that foreign investors can buy expire by mid Jan-11.
I.I.P Growth	2.5%-3.5% Dec-11	-5.95% Nov-11	IIP is expected to remained subdued and register below 5% growth during the remaining months of FY12 as production activity continues to be impacted by the slowdown in the investment demand and weak business and consumer sentiment.
GDP Growth	6.7% Q3 FY12	6.9% Q2 FY12	
15-91 days T-Bills	8.4%-8.6% Jan-12	8.53% Dec-11	Going ahead, the credit growth is expected to be restrained as corporate sentiment continues to remain weak on account of high interest rates and political gridlock on economic reforms. The yields in the gilts market is expected to remain elevated in the near term as the government increased its borrowing by around Rs 400 bn for FY12. Moreover, the tight liquidity conditions prevailing in the money market is expected to put an upward pressure on the short terms yields.
10 year G-Sec Yield	8.5%-8.7% Jan-12	8.63% Dec-11	
Bank Credit*	16.0%-16.2% Jan-12	15.9 % Dec-11	

All figures are monthly average

* Refers to End Period

The wait for reforms continues…

India's recent economic performance has been disappointing and expectations for economic growth rate have been sliding down inexorably. The downside risks to the economic growth have increased significantly over the last few months. While uncertain global economic conditions threaten to constrain India's growth potential, there are home-grown risks too that undermine India's medium term growth outlook. Price pressures have persisted long enough, investment has slackened, volatility in industrial production series continues to confound analysts, capital inflows are faltering, combined fiscal deficit remains unsustainably high and current-account deficit is drifting towards 4% of GDP. The current macro-economic conditions are hostile to growth and is therefore repelling both domestic and foreign investors. The prevailing sentiment is truly exemplified in the D&B Business Optimism Index for Q1 2012, which has declined by as much as 8.8% as compared to Q1 2011. The questions on new skepticism regarding the Indian economy and possibility of economic downturn continue to hound Indian corporates and investors alike.

With no significant economic reforms carried out since 2004, the rapid global growth of the past decade and windfall of investment allowed our governments to take the eye off the ball, in terms of the reform agenda. India's unique combination of IT skills, its labour advantages, capital flows and pool of ambitious outward looking companies gave it an advantage across sectors - in manufacturing, services and agriculture. The rise of the middle class and their aspirations, increasing urbanisation and surge in income levels resulted in a compelling shift in consumer behaviour pattern over the years.

Our success however created new urgencies. The economy needed solutions to tackle its crumbling infrastructure and unshackle the education system. There was an urgent need to enact labor reform laws that was critical to create large scale jobs in the industrial sector. However, critical reforms in the areas such as labour, infrastructure, agriculture, education and health remained tangled up in the politics of coalition. The continuation of India's economic policy stasis has led to widening of income inequalities.

The slowdown is bringing home the reality that in the long run, half-done reforms gives terrible result in terms of inequality, growth and political unrest. In order to revive confidence and lure investors, the Government needs to act far more decisively and rapidly than it currently is doing. And unfortunately it is the most controversial reforms that will also create the most access and broad based development such as labour reforms or the removal of monopolies in the agricultural sector that keep crop prices stagnant and limit choices of sellers for farmers.

In the following section, we look at some of the areas wherein the slow pace of reforms has deterred economic growth.

Structural Issues in Agriculture - Chronic price pressures continue to plague the economy with WPI inflation being sticky and averaging over 9% for nearly two years. A decomposition of food articles inflation indicates that the persistence of protein inflation has changed the inflation dynamics. While the structural forces, in particular, shifting dietary patterns and income increases are generating enormous demand for proteins, the supply chain is clearly struggling to meet this demand. It is structural reforms, rather than monetary policy tightening that holds the key to keep food inflation under check.

Transportation, storage and distribution efficiency have to be increased to keep losses and distribution margins down. There is an urgent need for states to move towards full adoption and faster implementation of the APMC Act. The amendments presented in the APMC Act seek to significantly boost farm income by eliminating the role of intermediaries. Moreover, faster implementation of other initiatives of GoI such as provision of extension services and farm mechanisation is warranted for improving productivity and efficiency in the agriculture sector.

Labour Reforms - Restructuring the labour market and bringing unorganised labourers within the ambit of the organised sector is a longstanding need to match the pace of liberalisation and globalisation. Capital intensity is unnaturally high for a country with so many available workers. It is no longer sustainable for a country of our size and with its upcoming demographic surge to rely on the service sector to create the mass of jobs it needs. A large proportion of unemployed and seasonal workers are bound to create economic instability.

Infrastructure - The lack of effective infrastructure has been one of the key factors behind the inequalities emerging within India's markets. With the exception of telecom- the other sectors such as power, roads and urban infrastructure are fraught by long histories of a subsidy culture and dual(centre and states) constitutional responsibilities. Structural reform and regulatory barriers have impeded the flow of capital into infrastructure. The Government can no longer wait to introduce reforms that remove bottlenecks from existing sources of capital (banks) and ease norms in the bond and pension markets so as to stimulate the flow of capital into infrastructure assets. Increasingly, the hope for infrastructure in India resides in partnership with the private sector. However, improvement in the risk-return equation for private players necessitates addressing various challenges pertaining to project implementation, contract enforceability and land rights.

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