



Decide with Confidence

### View from the top

#### Dun & Bradstreet's Macro Economic Forecasts

	Forecast	Latest Period
Inflation W.P.I	10.9%-11.1% Jul-10	10.55% Jun-10
Inflation C.P.I (I.W)	13.5%-13.7% Jun-10	13.91% May-10
INR/US\$	46.40-46.60 Jul-10	46.56 Jun-10
I.I.P Growth	8.5%-9.5% Jun-10	11.52% May-10
15-91 day's T-Bills	5.2%-5.4% Jul-10	5.23% Jun-10
10 year G-Sec yield	7.3%-7.5% Jul-10	7.39% Jun-10
Bank Credit*	19.8%-20.0% Jul-10	19.6% Jun-10

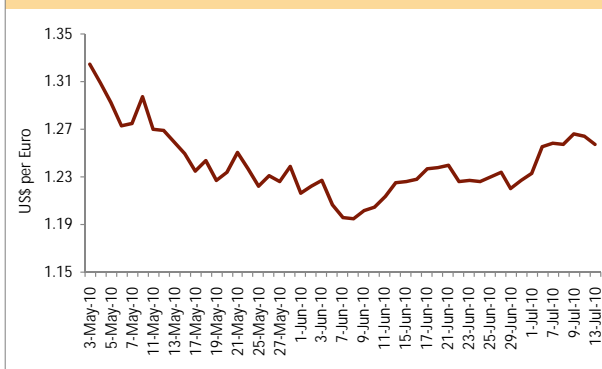
All figures are monthly averages

\*Refers to End period

#### Dun & Bradstreet's GDP Forecasts (% y-o-y growth)

	Forecast (Q1 FY11)	Latest Period (Q4 FY10)
GDP	8.6	8.6
Agriculture	2.7	0.7
Industry	10.7	13.3
Services	9.2	8.4

#### Movement in Euro-Dollar Exchange Rate



Source: IMF

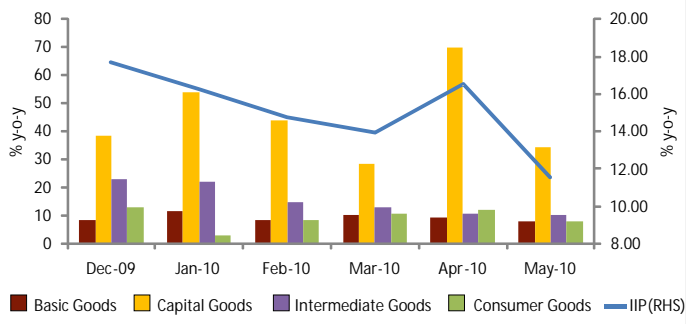
The recent moderation in IIP growth should not be a cause for concern given that the lower pace of growth is partly a statistical phenomenon due to base effect of the previous fiscal. Moreover, this growth rate is a sign of consolidating industrial activity. In fact, IIP growth is likely to remain around the current level in the next few months given that the industrial production is likely to consolidate further and the impact of low base would wane-out gradually. Several other factors such as bank credit, auto sales, advance tax collection, imports and exports have shown signs of improvement in the past few months pointing to resilience of the domestic economic activity.

Although the economy seems to be marching towards a high growth path, there do exist some downside risks to growth that include mounting inflationary pressures, fallout of the European debt crisis and irregularity in advancement of monsoon. Any untoward development surrounding advancement of monsoon on the domestic front and European debt crisis on the external front could pose significant risks to growth prospects given that private demand is still in the recovery phase. Inflation, which is already at elevated level, is likely to surge further in the next few months as the impact of the recent deregulation of fuel prices becomes evident.

According high priority to inflation management, the RBI raised the repo and reverse repo rates by 25 basis points almost a month before the scheduled monetary policy review. Containing inflation is extremely crucial as high inflation would not only affect the domestic demand conditions but also could put pressures on profit margins of the corporates. Thus, D&B expects that RBI would tighten its monetary stance further in the forthcoming policy review with a 25 bps increase in both repo and reverse repo rates. Going forward, anchoring inflationary expectations will remain at the forefront of the policy agenda, as demand side pressures to inflation are likely to surface once domestic demand gathers strength. However, expectation of further monetary tightening is underscored by an assumption of a normal monsoon - any deviation in monsoon is likely to create a dilemma on the policy front. Moreover, any action on the monetary policy front will have to be synchronised with orderly management of the Government's borrowing programme. The volatility in the rupee value could also pose further challenge to monetary management. Thus, the monetary actions would have to be calibrated taking into consideration a confluence of such factors that exert opposite influences on the direction of monetary policy.

# Real Economy

## Moderation in the industrial activity, base effect at play



Source: CSO

- The IIP grew by 11.5% (y-o-y) in May-10 lower compared to a downward revised 16.5% in Apr-10.
- The capital goods sector grew by 34.3% (y-o-y) during May-10 a moderation as compared to the high growth of 69.9% registered during Apr-10.
- Intermediate goods sector clocked a growth of 10.2% during May-10, thereby contributing around 24.6% to the overall IIP growth.
- The growth in consumer non-durables sector continued to remain muted; IIP in consumer non-durables grew by 2.4% during May-10.

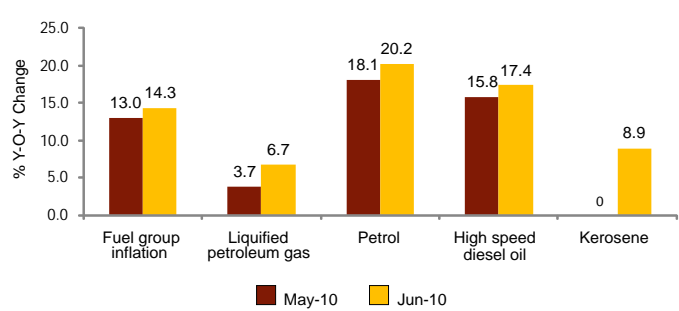
	Forecast	Actuals	
		Latest Period	Previous Period
I.I.P Growth	8.5%-9.5% Jun-10	11.52% May-10	16.52% Apr-10

The IIP figures recorded a double digit growth rate for the eight consecutive months in a row. However, the 11.5% growth figures for the month of May 10, lower as compared to 16.5% (downward revised) during April 10, shows a moderation in the industrial activity, which is partly a statistical phenomenon due to the base effect. The moderation in the IIP growth numbers should not be a cause for concern as the industrial activity seems to be on a consolidation phase. With further consolidation in the industrial activity and waning out of the base effect, IIP numbers are expected to be at around the current growth levels in the near term.

The positive growth registered by 15 out of 17 industries indicates that the industrial activity is broad based and strengthens the prospects of a sustainable growth. Though capital goods grew at a lower rate than the previous month, it still continues to grow at a significant rate of 34.3%. Moreover, stable performance in the intermediate goods and robust growth in the consumer durables sector on the back of improving labour market conditions augur well for the industrial activity in the near term. Managing the mounting inflationary pressures in the economy continue to be at the forefront of the RBI's policy agenda and would result in high interest rate scenario going forward. This is likely to have some moderating impact on the investment activity, especially in the second half.

# Price Scenario

## The direct impact of the recent fuel price hike on fuel group inflation



Source: Ministry of Commerce

- The WPI inflation surged further to 10.6% during Jun-10 as against 10.2% during May-10.
- The WPI inflation figure for Apr-10 revised significantly upwards by 1.6 percentage points to 11.2%.
- Inflation in primary articles continued to remain elevated at 16.3% during Jun-10 due to higher prices of minerals and primary food articles, particularly pulses.
- Inflation in the fuel group surged to 14.3% during Jun-10 as against 13.05% during May-10, reflecting direct impact of the recent fuel price hike.
- Inflation in manufactured products stood at 6.7% during Jun-10 as against 6.41% during May-10.

	Forecast	Actuals	
		Latest Period	Previous Period
Inflation W.P.I	10.9%-11.1% Jul-10	10.55% Jun-10	10.16% May-10
Inflation C.P.I (I.W)	13.5%-13.7% Jun-10	13.91% May-10	13.33% Apr-10

All figures are monthly averages

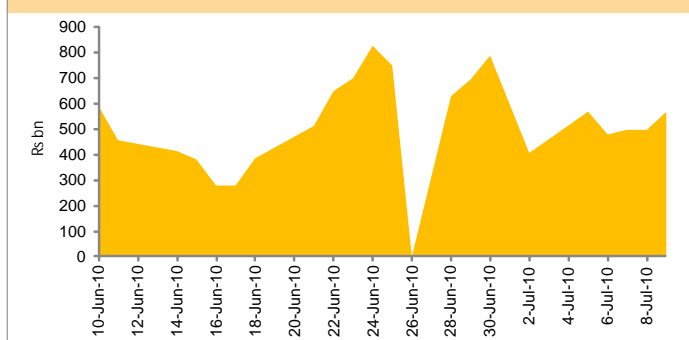
The deregulation of fuel prices are expected to aggravate inflationary pressures in the economy. While the direct impact of fuel price rise on overall inflation has already been reflected in the WPI figures for June, its second round impact will start showing up from mid-July through higher transportation costs and increased prices of several other commodities, both food and non-food.

The mounting inflationary pressures will not only affect domestic demand but will also impact profit margins of the corporates as it will be difficult for them to pass on the complete rise in input costs to final consumers given that the domestic demand is yet in the recovery phase. Besides, the demand side pressures that are likely to surface once the domestic demand strengthens will further push the headline inflation upwards. In view of the persistent inflationary pressures in the economy, the RBI is expected to further tighten its monetary policy in the forthcoming monetary policy review.

Nonetheless, some easing of global commodity prices given the slow recovery in the US, prospects of better agriculture production in anticipation of normal monsoon and waning statistical base effect are expected to ease off inflationary pressures in the economy to certain extent after Sep-10.

# Money & Finance

**Net injection of liquidity through RBI's Repo window**



Source: RBI

- The RBI hiked Repo & Reverse repo rates under the Liquidity Adjustment Facility (LAF) by 25 basis points each to 5.50% and 4.00% with effect from 02-Jul-10.
- The additional liquidity support to SCBs under the LAF to the extent of upto 0.5% of their NDTL which was set to expire on 02-Jul-10 was extended upto 16-Jul-10. For any shortfall in maintenance of SLR arising out of availment of this facility, banks may seek waiver of penal interest purely as an ad hoc measure.
- The second LAF to be conducted on a daily basis upto 16-Jul-10.
- Growth in bank credit registered some increase to 19.60% outstanding as on 18-Jun-10 as against 18.00% outstanding as on 21-May-10.

	Forecast	Actuals	
		Latest Period	Previous Period
<b>15-91 day's T-Bills</b>	5.2%-5.4% Jul-10	5.23% Jun-10	4.13% May-10
<b>10 year G-Sec yield</b>	7.3%-7.5% Jul-10	7.39% Jun-10	7.39% May-10
<b>Bank Credit*</b>	19.8%-20.0% Jul-10	19.6% Jun-10	18.1% May-10

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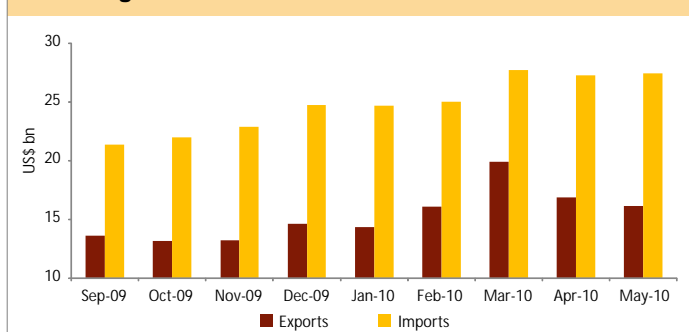
The acceleration in non-food inflation, strong recovery in the industrial activity, deregulation of fuel products and anticipation of its cascading impact on overall inflation going forward induced the RBI to announce hike in key policy interest rates a month ahead of the first quarter policy review scheduled in July. Nonetheless, given the tight liquidity conditions, the CRR was kept unchanged.

The liquidity conditions in the banking system continued to remain tight as reflected by the firming up of the call rates which largely remained above the upper bound of LAF. The net injection of liquidity through the repo window also surged to almost Rs 11,311.6 bn between 10-Jun-10 to 9-Jul-10. Nonetheless, reduction in GOI auction quantum by Rs 30 bn helped in easing liquidity pressures to a certain extent. Further, the draw down on the government's cash balances with the RBI that will inject liquidity in the system is expected to improve liquidity conditions in the near future.

The recent hike in fuel prices which is expected to further aggravate inflationary pressures might call for further tightening of the monetary policy in the near future. D&B expects a further increase of 25 basis points in Repo & Reverse repo rates each in the forthcoming monetary policy review.

# External Sector

**Widening trade deficit**



Source: Ministry of Commerce

- India's trade deficit for May-10 surged to US\$ 11.29 bn on account of a higher growth in imports (38.5%) relative to exports (35.1%).
- The higher trade deficit combined with the lower invisibles surplus widened the current account deficit to a record high of US\$ 12.99 bn during Q4 FY10 as against a deficit of US\$ 1.21 bn in the year ago period.
- Services receipts recorded a growth of 13.4% led by software and financial services during Q4 FY10.
- The continued buoyancy in capital inflows during Q4 FY10 resulted in net capital account surplus of US\$ 16.1 bn as compared to US\$ 1.4 bn during Q4 FY09.
- Rupee continued to be volatile during the month of Jun-10 and stood at 46.93 per US\$ on 13-Jul-2010.

	Forecast	Actuals	
		Latest Period	Previous Period
<b>INR/US\$</b>	46.40-46.60 Jul-10	46.56 Jun-10	45.80 May-10

All figures are monthly averages

Given that the Indian economy is expected to recover faster compared to most of its major trading partners, the growth in imports is likely to be relatively higher compared to exports thereby leading to widening of the trade deficit. While higher trade deficit would exert pressures on the current account, some respite is expected from growing services exports coupled with increased remittances from abroad as compared to previous year.

On the capital account front, India is expected to attract foreign fund inflows given the strong growth prospects of the economy. Moreover, the interest rate differential between India and other developed countries is expected to widen going forward thereby attracting more investment in India.

With expected increase in capital inflows, D&B expects the rupee to follow an appreciating trend in the medium to long run period. However, impact of a host of factors such as developments surrounding the European debt crisis, deregulation of Chinese currency and growth scenario in the US would render rupee volatile in the short term. D&B expects the rupee to average at around 46.40-46.60 per US\$ during Jul-10.