

# D&B ECONOMY OBSERVE



Decide with Confidence

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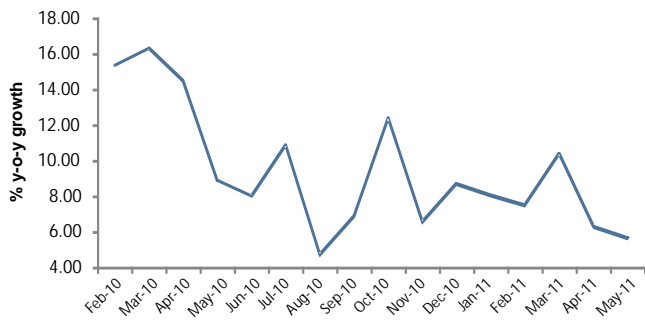
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With the ongoing state of events in the worlds most developed as well as developing countries, the global economic sentiment has turned dismal adding uncertainty to the pace of global growth. Factors such as the sovereign debt crisis in the euro region seemingly entering into a systemic phase amid growing concerns that it will spill over to other European countries as well, weak economic activity in the US affected by the labour, housing as well as the government fiscal balances, sustained political unrest in the MENA region, Japan still to recover from the devastating aftereffects of the massive earth quake and rising interest rates in the Chinese economy continue to afflict the global sentiment. Reiterating the sentiment the Composite leading indicators (CLIs) released by the OECD point to a deceleration in the pace of recovery; (CLIs) for 33 OECD member countries eased for a second straight month in May-11.

In the midst of global uncertainty that continues to perturb the sentiment, the recently released IIP numbers for May-11 further adds to the uncertainty prevailing over the growth prospects of the Indian economy. More so, as the revised numbers for the month of Apr-11 show a sharp revision making it increasingly difficult to decipher the trend; intermediate goods revised upwards 3.5% to 4.5%, manufacturing sector was revised downwards from 6.8% to 6.3% and capital goods significantly revised downwards from 14.5% to 7.3%. Nonetheless, the revised numbers indicate the loss of momentum in the manufacturing activity as corporate firms face margin pressure owing to rising input as well as borrowing costs and restrained demand. Further, the credit demand by the manufacturing sector remained weak during the recent past. The break up of the incremental share of credit deployed to the industrial sector, for the period 25-Mar-11 to 20-May-11, reveals that most of the credit was deployed to the infrastructure sector (63.9%) followed by the petroleum, coal products and nuclear sector (23.5%). Within the infrastructure sector most of the credit went to the power sector indicating that the credit demand by the manufacturing industries remained weak. The investment activity in the manufacturing sector also remains weak. Investment in new projects in the manufacturing sector stood at Rs 1,685 bn during Q1 FY11, lower by around Rs 1,060 bn from the same quarter of previous year, while the investment in new projects announced had increased by around Rs 2,441 bn during Q1 FY10 on a y-o-y basis. Thus, the near as well as medium term outlook for the manufacturing sector continues to remain dismal owing to supply side bottlenecks along with anticipated subdued demand conditions. According to D&B's business optimism survey, majority of the respondents indicated the selling prices of their products to remain unchanged during Q3 2011.



**Loss of momentum in the manufacturing activity**

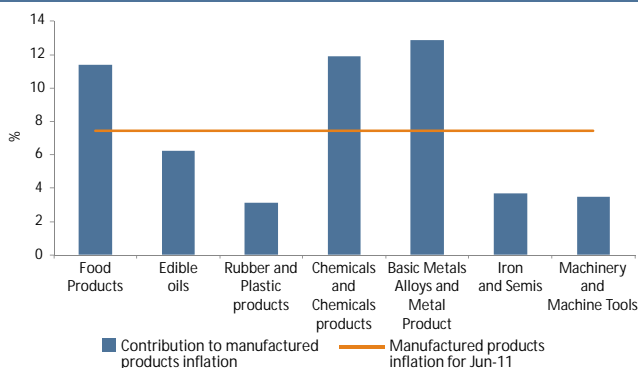


Source: CSO

**Real Sector**

- IIP growth slowed down to 5.6% during May-11. The data for Apr-11 was revised downwards from 6.3% to 5.8%.
- While manufacturing and the mining sectors continued to be the laggards growing by 5.6% and 1.4% respectively, electricity sector posted a strong growth of 10.3% during May-11.
- Capital goods grew by 5.9% while intermediate goods grew by 0.9% indicating conservative demand forecasts from manufacturers.
- Consumer goods sector recorded a growth of 5.4% (y-o-y) during May-11 against 4.3% in Apr-11. Consumer durables and Consumer non durables grew by 5.2% and 5.6% respectively.

**Manufactured products prices continue to edge up during Jun-11**

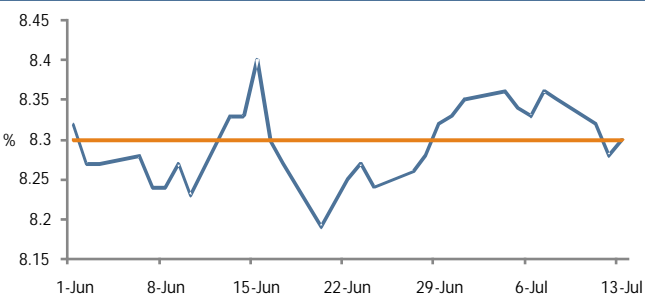


Source: Ministry of Commerce & Industry

**Price Scenario**

- Headline inflation edged up to 9.4% during Jun-11 as compared to 9.1% during May-11.
- WPI for primary articles grew by 12.2% during Jun-11 after moderating to 11.3% during May-11.
- The inflation for the fuel group recorded a rise of 12.9% during Jun-11. In May it had grown by 12.3%.
- Mineral oil prices inched upwards to 16.8% during Jun-11 as compared to 15.9% during May-11.
- Within mineral oils, inflation for LPG, petrol, and high speed diesel stood at 12.2%, 30.6% and 6.6% during Jun-11 as compared to 11.3%, 27.3% and 5.5% respectively during May-11.
- The manufactured product prices continued to remain elevated at 7.4% during Jun-11.

**Yields inch higher owing to tight cash conditions & rising rates**



Source: Reuters

Note: The graph represents yield of the 10-year benchmark bond  
The line represents the avg of 10-year bond for the period 1-Jun to 13-Jun' 11

**Money & Finance**

- Bank credit to industry increased by 26.7% (y-o-y) in May-11 as compared to 25.8% during May-10 led by infrastructure, metal and metal products, engineering, mining, quarrying, rubber and plastic products.
- Credit to services sector increased by 21.8% during May-11 against 15% in the previous year.
- Personal loans registered a growth of 17.7% in May-11 against 5.6% in corresponding period last year. Credit to consumer durables, housing, advances against fixed deposits and vehicle loans witnessed substantial increase over previous year.
- Bank credit to agriculture and allied sectors moderated to 12.8% (y-o-y) during May-11 compared to 21% recorded during the corresponding period last year.

**Overseas investment on a rise while inward FDI slows down**



Source: RBI

**External Sector**

- Indian exports rose by 56.9% (y-o-y) to US\$ 25.9 bn during May-11 while imports rose by 54% (y-o-y) to US\$ 40.9 bn leading to trade deficit of US\$ 15 bn.
- The current account deficit moderated to US\$ 5.4 bn in the fourth quarter ended Mar-11 against a deficit of US\$ 12.8 bn in the year ago period owing to growth in invisible surplus coupled with reduced merchandise deficit.
- The capital account surplus reduced to US\$ 8.2 bn in the fourth quarter ended Mar-11 against US\$ 15.8 bn in the year ago period as the economy witnessed lower FDI and portfolio investment.
- Net FDI remained lower primarily on account of moderation in the FDI inflows and significant increase in the overseas investment by Indian corporates.



## Dun & Bradstreet's Macro Economic Forecasts

	Forecast	Latest Period	D&B's Comments
<b>Inflation W.P.I</b>	8.9%-9.1% July-11	9.44% Jun-11	WPI inflation expected to subside from the current levels primarily owing to the abatement of the food articles inflation. Further, moderation of demand side pressures impacted by the monetary tightening is also expected to support the downward trend going forward
<b>Inflation C.P.I (I.W)</b>	8.9%-9.1% Jun-11	8.72% May-11	
<b>Exchange Rate INR v/s US\$</b>	44.40-44.60 July-11	44.85 Jun-11	Rupee is expected to remain volatile, owing to the uncertainty imposed by the global events, with an upward bias as foreign investors continue to seek gains from the prevailing interest rate differentials
<b>I.I.P Growth</b>	5.5%-6.5% Jun-11	5.62% May-11	High input prices as well as borrowing costs at a time when manufacturers are finding it difficult to raise the selling prices anticipating subdued demand is likely to keep the IIP production muted going forward.  Elevated level of interest rates is likely to restrict the investment growth rate and thereby the overall IIP growth going forward
<b>GDP Growth</b>	7.7% Q1 FY12	7.8 Q4 FY11	
<b>15-91 days T-Bills</b>	7.9%-8.1% July-11	8.00% Jun-11	The lagged impact of the successive policy rate hike and expectations of further interest rate hikes coupled with inflationary pressures are expected to exert upward pressure to the yields in the long term bonds higher, while liquidity pressures would keep the yields in the short term bonds elevated.
<b>10 year G-Sec Yield</b>	8.2%-8.4% July-11	8.44% Jun-11	Credit growth is expected to witness some moderation with the dipping of the investment intention of the corporates owing to rising input prices and subdued demand conditions
<b>Bank Credit*</b>	19.3%-19.5% July-11	19.6 % Jun-11	

All figures are monthly average

\* Refers to End Period



## Managing the Demographic Dividend

India is in the middle of a profound socio-economic transformation driven by demographic change. With a bulge of population in the working age group (15-59 years), India has one of the most favourable demographic profiles amongst developing Asian economies as well as amongst the BRIC economies. The decline in mortality (brought about by health improvements that affected people at all ages) and fertility rates over decades has altered the population age structure. Between 2001 and 2026, because of the declining fertility, the proportion of population aged under 15 years is projected to decline from 35.4% to 23.4%; while the proportion of the middle (15-59 years) and the older ages (60 years and above) are set to increase considerably. The proportion of population in the working age-group 15-59 years is expected to rise from 57.7% in 2001 to 64.3% in 2026. The favourable age composition can have a major impact on economic growth through various channels, which are often referred to as “demographic dividends”. As people tend to save more between the ages of 45-60, a lower dependency ratio can boost India's savings rate and in turn facilitate investment spending.

The change in the population age distribution matters because individuals vary their economic behaviour at different ages. Empirical support for the relationship between the age structure transition and economic growth is mixed. Studies in the past have shown that nearly one-third of the “economic miracle” of East Asian countries can be attributed to the demographic dividend. In Ireland, the 1980 legalization of birth control sparked a decrease in the birth rate. The rapid decline in dependency ratio in turn spurred economic growth. On the other hand, some not-very-optimistic views on the relationship between age structure and economic development are also observed in the case of developing countries.

This brings to the fore the point that benefits associated with the links between demographic change and economic growth do not accrue automatically. Capturing the benefits conferred by the dividend is contingent upon providing an economic environment in which the projected working-age population are productively employed. This would require creating an efficient infrastructure and effective investments in health, education and skill development.

Even as India's total working-age population is poised to rise, the current pace of job creation continues to be sluggish. Labour force participation rate - the proportion of population which supplies or offers to supply labour for pursuing economic activities— is relatively low in India. Results of the 66th round of the National Sample Survey Organisation (NSSO) indicate tightness in the labour market. The Worker Population Ratio (number

of persons/person-days employed per 1000 persons/person-days) showed a decline to 39.2% in FY10 from 42% on FY05. More worryingly, there has been a sharp decline in the female labour force and the workforce participation rates as per all the three criteria (the usual, weekly and daily status) in rural and urban areas as compared to FY05. The proportion of female labour in the total population has dropped from 215 per 1,000 in FY05 to 179 per 1,000 in FY10. Male employment also shows a sharp deceleration and is much below the 11th plan target.

Bulk of the employment in India continues to remain concentrated in the agriculture sector even though the sector contributes less than 20% to GDP. As per the NSSO survey, 63% of male workers in rural areas are engaged in agriculture. The percentage engaged in secondary and tertiary sectors stood at 19% and 18%, respectively. Most of the workers engaged in agriculture are highly under-employed with very low levels of return. The share of manufacturing sector in employment generation was just 13% in FY05. Moreover studies have pointed that labour intensity has decreased across all the labour-intensive sectors in registered manufacturing in the country. The increase in capital intensity (declining labour intensity) - even though not accompanied by a rise in capital productivity - in the manufacturing sector is an offshoot of India's restrictive labour laws. For instance, labour laws restrict units that employ more than 100 workers from firing employees. There is a need for focused policy initiatives to increase the share of manufacturing in employment generation.

Another major deterrent in employment generation is the quality of labour. It is estimated based on NSSO data for FY05 that only 2% persons in the age group of 15-29 years have received formal vocational training and around 8% are reported to have received non-formal vocational training. The shortage of trained skilled workforce has the potential to slowdown overall workforce quality and productivity growth. There is a need to enhance the skill development infrastructure (especially in rural areas) in a manner that all those who enter the labour force acquire relevant skills beforehand.

Most demographic indicators vary enormously across Indian states. Of the projected increase in population of 371 million in India during 2001-26, 187 million is likely to occur in the seven States of Bihar, Chhattisgarh, Jharkhand, Madhya Pradesh, Rajasthan, Uttar Pradesh and Uttaranchal. These states have traditionally been known to score low on various human development indicators. There is need for significant overhaul of employment infrastructure in these states so as to reap the benefits of the demographic dividend.

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

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