



Decide with Confidence

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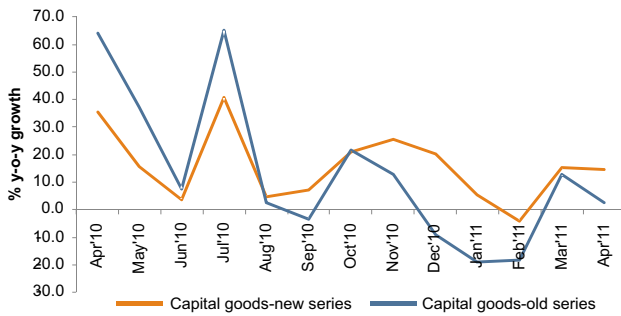
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Reflecting the moderating pace of economic activity, the GDP growth continued its downward trend during the fourth quarter as well. Given the dismal performance in the industrial sector and the moderation in the services sector, it was the robust output in the agricultural sector during Jan-Mar 11 which helped the GDP to grow by 7.8%. The new series on IIP (which included revisions in base year, weights and new components) from Apr-11, also show a slowdown in the industrial activity from the levels recorded during Mar-11. Notably, according to the new data series IIP registered a high growth rate of 6.3% as compared to only 4.4% as per the old series. Also, a trend analysis of the used based classification of the new IIP series highlights resilient growth in capital goods production raising questions regarding concerns on slowing investment activity. According to the old series the data on the capital goods segment, which is an indicator of the investment activity, remained negative at an average of 5.3% during Dec-10 to Apr-11, while the new data series reports that the capital goods segment posted a robust growth of 10.3% during the same period. However, it would be too early to be able to conclude about the pattern and momentum in the investment activity based on the current series of capital goods. More so, when factors such as hardening of interest rates and unrelenting rise in input prices might pose as major impediments to the investment activity and hence the industrial production going forward. Another cause of concern is the lower output in the mining & quarrying sector as this might also pose bottlenecks regarding the availability of raw materials to the manufacturing sector.

Nonetheless, as the price pressures, especially, on the manufacturing front continue to pose significant risk and given the better than expected growth in IIP we expect the RBI to continue with its policy tightening regime; increasing the repo rates by another 25 basis points in the upcoming policy review. Thus, going ahead, we anticipate the economic activity, both the investment as well as the demand, to remain subdued. Besides, the sustained rise in prices, there exists certain other risks which has the potential to further clamp down the overall growth levels such as the shortage of infrastructure, especially in the power sector, the continued political turmoil in the in the MENA region and the crisis in the euro area and the possibility of further contagion in the region.



Capitals goods post higher growth as per the new series

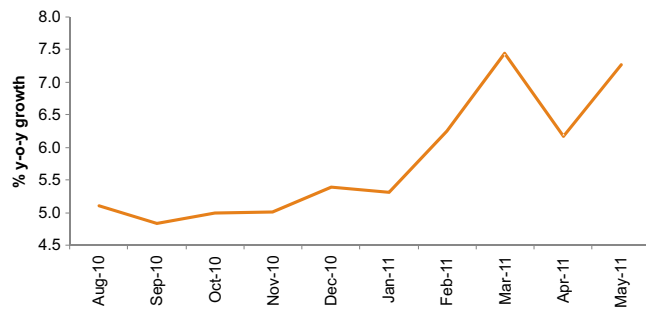


Source: CSO

Real Sector

- GDP grew by 7.8% during Q4 FY11. While the agriculture sector recorded an impressive growth of 7.5%, industry grew by 6.1% and services sector grew by 8.7%.
- According to the new series, IIP grew by 6.3% during Apr-11 after growing by 8.8% during Mar-11 while according to the old series IIP grew by only 4.4%.
- According to the revised series the capital goods sector recorded an impressive growth of 15.4% during Mar-11 and 14.5% during Apr-11.
- The consumer goods segment grew by 2.9% during Apr-11 as compared to a growth of 11.7% during Mar-11. The consumer durables sector grew by only 3.8% as compared to an average growth of around 14% recorded during FY11 mainly owing to the base effect.

Manufactured prices continue to remain elevated

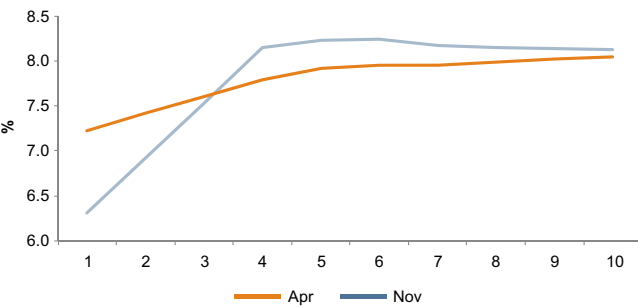


Source: Ministry of Commerce & Industry

Price Scenario

- The WPI headline inflation surged to 9.06% during May-11, after moderating to 8.7% during Apr-11.
- Primary articles witnessed a slight moderation to 11.3% during May-11 as compared to a growth of 12.1% during Apr-11.
- Manufactured products inflation inched upward, recording a growth of 7.3% during May-11, as compared to 6.2% during Apr-11.
- Within the manufactured sector inflation for cotton textiles and chemical and chemical products witnessed a significant rise to 29.9% and 7.1% during May-11 as compared to 24.7% and 6.1% respectively during Apr-11.
- Within the fuel group petrol prices spiked to 27.3% during May-11 as compared to 21.8% recorded during Apr-11.

Yield curve tends to invert

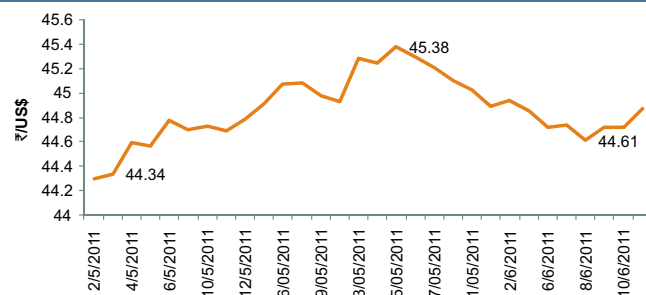


Source: RBI

Money & Finance

- Non-food bank credit increased by 22.1% (y-o-y) during Apr-11 as compared to 17.1 recorded during the corresponding period of last year.
- Credit to industry increased by 25.9% (y-o-y) in Apr-11 as compared with 24.4% during Apr-10, led by infrastructure, metals, engineering, food processing, mining & quarrying and rubber, plastic and their products.
- Personal loans registered a larger growth of 18.4% during Apr-11 as compared with 4.4% during Apr-10.
- Yield on the 10-year bond remained in the range of 8.13 - 8.46% during the month of May-11.

Rupee remains volatile



Source: RBI

External Sector

- India's exports rose by 34.4% (y-o-y) to US\$ 23.8 bn during Apr-11, while imports rose by 14.1% (y-o-y) to US\$ 32.8 bn, leading to a trade deficit of US\$ 8.9 bn.
- While oil imports grew by 7.7% (y-o-y), non-oil imports grew by 17.3% (y-o-y) during Apr-11.
- India's total foreign exchange reserves have increased to US\$ 310.21 bn as on 27-May-11 as compared to US\$ 294.01 bn at the beginning of Jan (As on 7-Jan-11).
- Rupee witnessed a depreciation of around ₹1 when it touched 45.38 per US\$ on 5-May-11 as compared to its level on 2-May-11.



Dun & Bradstreet's Macro Economic Forecasts

	Forecast	Latest Period	D&B's Comments
Inflation W.P.I	8.6%-8.8% June-11	9.06% May-11	Inflationary pressures in the economy will continue to remain entrenched during the forthcoming quarter. Any further spike in food inflation (in the event of unfavourable monsoon) could bring about an ominous turn in general inflation. WPI inflation may start moderating from the beginning of Q3 FY12 as the monetary policy tightening by the RBI will start showing its impact.
Inflation C.P.I (I.W)	8.7%-8.9% May-11	9.14% Apr-11	
Exchange Rate INR v/s US\$	44.50-44.70 June-11	44.90 May-11	The rupee is expected to remain strong in the forthcoming months, as foreign fund inflows owing to interest rate differentials will continue to provide support to the domestic currency. Nonetheless, downside risks to the rupee may emanate in the event of further rise in global crude oil prices and major change in global macro-economic conditions.
I.I.P Growth	6.5%-7.5% May-11	6.34% Apr-11	The continued moderation in the economic activity, elevated input prices coupled with rising interest rates would continue to play a key role in moderating overall industrial activity. Given the adverse base effect, IIP growth is expected to remain subdued during May-11. Sustained elevated level of global crude oil prices, high input prices and further anticipated hike in the policy rates are expected to restrain the overall economic growth during the first half of the current fiscal.
GDP Growth	8.1 Q1 FY12	7.8 Q4 FY11	
15-91 days T-Bills	7.7%-7.9% June-11	7.73% May-11	The lagged impact of policy rate hikes by the RBI and continued rise in inflationary pressures would keep bonds yields at elevated levels for most part of FY12. Rising cost of funds for banks', owing to a hike in policy rate is expected to pose downside risk to credit growth going forward. As domestic interest rates firm up, Indian companies are likely to tap the ECB route to fund capital expansion plans.
10 year G-Sec Yield	8.0%-8.2% June-11	8.41% May-11	
Bank Credit*	21.8%-22.0% June-11	21.7 % May-11	

All figures are monthly average

* Refers to End Period



Environment and economic growth conundrum

India's economic ascendance over the last few years has produced many benefits—increases in income and employment levels, growth in foreign investment et al. Concomitantly, it has also brought to the fore discernible challenges. These relate, in particular, to widening rural-urban income gap, crippling infrastructure and fiscal issues. Population growth along with a move towards rapid urbanisation, industrialization, and massive investments in infrastructure development has also entailed wide-ranging environmental risks and challenges. The environmental problems are not only an ecological issue but have serious negative social and human consequences. For India, the impact has been in the form of declining agricultural area and productivity due to soil erosion, reduced labour productivity from urban air pollution, and the threat of toxic and chemical waste in the environment. The loss of biodiversity and the associated decline in ecosystem services also pose major risks.

- Respirable Suspended Particulate Matter (RSPM) - the main air pollutant for public health concern- is in excess of the National Ambient Air Quality Standards (NAAQS) in most cities.
- The increased dependence of the power sector on coal (especially cheap poor quality coal with high ash content- 40–50%) has led to India's relatively high carbon intensity and high air pollutant emissions especially SO₂.

In the face of such rising and credible evidence, it is no longer possible to ignore the crucial link between sustainable economic growth and the environment, and the role of environmental policy in managing the provision and use of natural assets. A demand for change and more effective action is building up and being recognized. The recent protest for the ban on endosulfan - an organochlorine pesticide, and known endocrine disruptor and neurotoxic - is a case in point. Attempts launched to adjust national income figures so as to include imputed values of environmental improvements and degradation is encouraging.

However, solving these challenges does not mean avoiding environmental degradation altogether, but rather containing the damage so as to allow human societies and natural ecosystems to co-exist. Environmental regulation and economic growth need not be seen as competing aims. Economic growth is essential to generate more revenues for the government to invest in both infrastructure and social welfare programmes. And it is growth alone that will create employment opportunities for India's bulging working-age population and give us the resources to invest in skill-development so essential to reap the "demographic dividend". Economic growth will also contribute to the investment needed for technological innovations that allow us to reduce our

environmental footprint while still providing the goods and services we need.

India has an extensive environmental management system. The environmental policies, plan, programs, norms and standards are also evolving to address the growing environmental concerns. However, recently concerns have emanated from the environment-sensitive policies adopted by the Government that have caused project delays in sectors such as mining, integrated township projects, infrastructure et al. While regulations may provide an effective framework for ensuring the sustainable use of natural resources, market-based approaches to environmental management such as payment for environmental services (PES) et al could also play an important role in slowing down environmental degradation, conserving environmental resources and improving the livelihoods of the marginalised sections of the society. Successful adoption of PES schemes in India however necessitates reforming the existing provisions of property rights and an enabling policy support amongst other things.

Within India and globally, businesses have increasingly begun to acknowledge that inaction towards environmental issues can be detrimental to long-term corporate profitability, competitiveness, and sustainability. Many companies have incorporated initiatives in their business operations through environmental management systems, voluntary codes of conduct and performance indicators. National Thermal Power Corporation (NTPC), for instance, has increased its fly ash utilization level from meagre 0.3 mn tons in FY92 to 27.61 mn tons in FY10. Few companies are also beginning to make commitments towards 'No Net Loss', 'Ecological Neutrality', 'Net Positive Impact' on biodiversity, or on specific ecosystem services such as water resources. However, a number of Indian companies are still way behind their global counterparts in adopting environment friendly practices and technology. While a number of companies in USA, Japan, Germany, France and UK have started issuing environmental, social or sustainability reports in addition to their annual financial reports, environmental reporting in India is still in infancy.

Since complying with environmental policy measures may imply additional costs and difficult choices to businesses, it is necessary that regulation is cost-effective so that it internalises the costs of pollution while minimizing negative economic or social implications for the regulated sectors and their customers. Policies that aid to improve the efficiency with which businesses use resources, will not only reduce negative environmental externalities but also provide financial savings for businesses. Herein lies the importance of good policy design in minimising any unavoidable trade-offs between environmental and economic policy goals.

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

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