



Decide with Confidence

Issue 47  
March 2011

## View from the top

## Contents

### View from the top

Page 1

### Macro Scan

Real Sector

Price Scenario

Money & Finance

External Sector

Page 2

### Economy Outlook

Page 3

### Special Article

Page 4

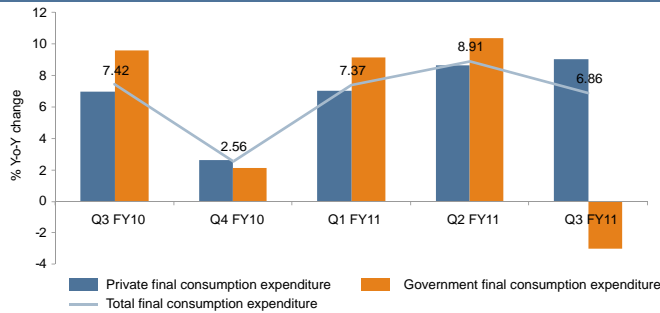
GDP growth moderated to 8.2% during the third quarter amidst high inflation, high interest rates, lower government expenditure and subdued investment activity. Although the economic activity moderated, mainly on account of the subdued industrial activity, as compared to the high growth levels recorded during H1FY11, we had anticipated the economic activity to consolidate during the second half of the current fiscal. Even as GDP grew above 8% on the back of a high growth in the agricultural sector (which grew by 8.9%), such a high agriculture growth has come as a surprise and is unlikely to sustain going ahead. The growth in GDP would have further moderated to slightly above 7%, if the agriculture sector would have grown by its long term average trend i.e. by around 3.5-3.6%.

Under the services sector, barring the financing, insurance, real estate and business services component which showed a buoyant growth the other two components had witnessed moderation. The considerable moderation in the community, social and personal service component which reflects lower government expenditure was expected given the unwinding of the Government's stimulus measures. Going ahead, the government expenditure is expected to remain muted given the lower budgeted expenditure of the government during FY12 to adhere to its fiscal consolidation agenda. In order to support growth, this slowdown in government demand must be backed by high growth in the private investment and consumption demand. While private demand conditions continued to remain buoyant, investment demand witnessed substantial moderation, with GFCF growing by only 6.0% during Q3 FY11, after growing at double digit growth rates since Q4 FY10. However, it needs to be seen how the investment activity pans out during the ensuing quarters before raising a note of caution. Nonetheless, we expect that the robust demand conditions, easing of liquidity conditions and the sustained growth in credit demand to keep the investment activity afloat going ahead.

Currently, the area of concern is the unabated rise in the global crude oil prices. While it will not only stoke further inflationary pressures it would also raise the subsidy burden of the Government. As per the current WPI data for the month of Feb-11, the headline inflation continued to inch upwards with the inflation in the fuel group, manufacturing products and non-food articles contributing to the upward pressure. The moderation in the investment activity on one hand and the building up of inflationary pressures, especially on manufactured products on the other hand would add to the monetary policy dilemma for the RBI.



### Private consumption continues to support growth

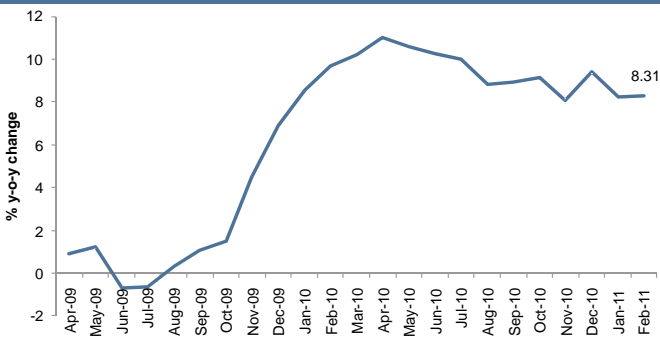


Source: CSO

## Real Sector

- India's GDP growth moderated to 8.19% (y-o-y) during Q3 FY11 after growing by 8.9% during H1 FY11. Agriculture sector clocked a robust growth of 8.95% during Q3 FY11 as compared to decline of 1.60% during Q3 FY10.
- Private consumption expenditure clocked a robust growth of 9.00% in Q3 FY11 on top of 8.63% during Q2 FY11. Government final consumption expenditure, however, recorded a decline of 3.01% during Q3 FY11 after growing by 10.39% during Q2 FY11.
- Investment activity is likely to have witnessed some moderation during Q3 FY11, with growth in gross fixed capital formation slowing to 6% during Q3 FY11 from a robust 17.84% growth in Q2 FY11.
- Growth in industrial production continued to remain muted; IIP grew by 3.7% during Jan-11 as compared to 2.5% during Dec-10.

### Inflation continues to remain elevated

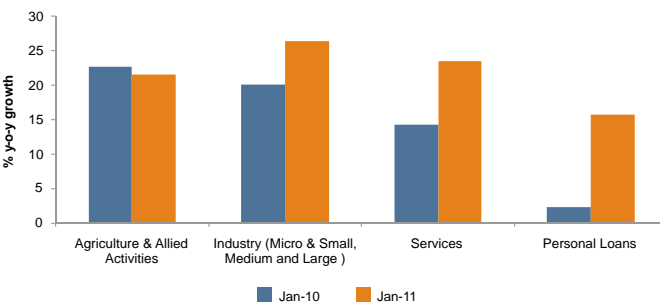


Source: Ministry of Commerce & Industry

## Price Scenario

- The WPI Inflation further rose to 8.31% (y-o-y) during Feb-11 as compared to 8.23% during Jan-11 owing to increase in fuel group and manufactured products inflation.
- Inflation in manufactured products marched upwards and stood at 4.94% (y-o-y) during Feb-11 as compared to a growth of 3.75% during Jan-11.
- Inflation for primary food articles declined due to lower prices of fruits & vegetables, moong, condiments & spices, egg and urad, and rice and masur. Inflation in primary food articles further moderated to 10.65% (y-o-y) during Feb-11 as compared to 15.65% during Jan-11.
- Fuel price inflation inched up to 11.5% during Feb-11 as compared to 11.4% during Jan-11, with continues surge in international crude oil prices. The ICE Brent crude oil prices touched US\$ 113.84 per barrel on 11-Mar-11.

### Improvement in Bank credit flows

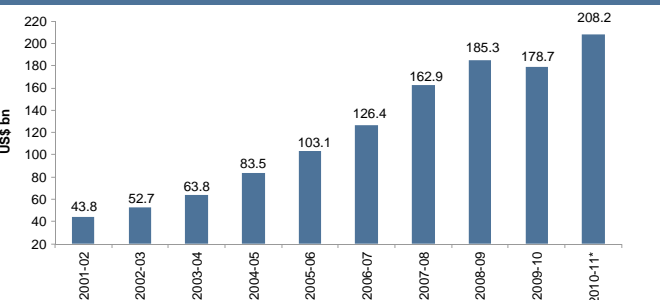


Source: RBI

## Money & Finance

- Flow of credit from banks continued to remain healthy, with gross bank credit recording a robust growth of 23.2% (y-o-y) outstanding as on 25-Feb-11 as against 15.9% in the year-ago period.
- Personal loans grew by around 15.8% (y-o-y) in Jan-11 as compared to a muted 2.3% growth during Jan-10, with most of the sub-segments such as housing, advances against fixed deposits, vehicle loans, education, etc., recording accelerated growth.
- Deposit growth continued to remain muted at 16.4% (y-o-y) outstanding as on 25-Feb-11 as compared to 16.9% in the corresponding period of the previous year.
- Yield on the 10-year bond remained in the range of 7.9-8.6% for the week ended 4-Mar-11, while 15-91 day treasury bill yield was in the range of 6.3-7.1% during the same period.

### India's Export cross US\$ 200 bn mark during FY11



Source: Ministry of Commerce

\* Data for FY11 pertains to Apr 10 - Feb 11

## External Sector

- India's exports registered a high growth of 49.8% during Feb-11, taking the cumulative exports for Apr 10 – Feb 11 to US\$ 208.2 bn.
- After declining by around 11.05% during Dec-10, imports grew by 13.14% (y-o-y) and 18.00% (y-o-y) during Jan-11 and Feb-11 respectively.
- India's total foreign exchange reserves have increased to US\$ 302.59 bn as on 4-Mar-11 as compared to US\$ 279.10 bn at the beginning of the current fiscal.
- Rupee ended at 45.21 per US\$ on 11-Mar-11.



## Dun & Bradstreet's Macro Economic Forecasts

	Forecast	Latest Period	D&B's Comments
<b>Inflation W.P.I</b>	7.9%-8.1% Mar-11	8.31% Feb-11	While food inflation continued to moderate with lowering food grain inflation, rising fuel inflation raises concern given that it has a potential to accentuate manufactured products inflation. Although lowering food articles inflation is likely to ease off some pressure on inflation front, high fuel prices pose a major upside risk to inflation. However, the headline inflation is expected to be marginally below the current levels owing to high base.
<b>Inflation C.P.I (I.W)</b>	8.9%-9.1% Feb-11	9.30% Jan-11	
<b>Exchange Rate INR v/s US\$</b>	45.10-45.30 Mar-11	45.44 Feb-11	With the expected rise in FII inflows the rupee value might experience some appreciation from the current levels. However, the persistent rise in global crude oil prices are expected to exert downside pressure on the rupee given the increased dollar demand by oil importers, thereby limiting the gains.
<b>I.I.P Growth</b>	4.0%-5.0% Feb-11	3.69% Jan-11	A confluence of factors such as improving domestic demand conditions, growing exports, increased infrastructure spending and gradual improvement in investment are likely to support the industrial activity going forward. However, high crude oil prices and rising interest rates coupled with the high base of previous year might limit the pace of IIP growth.  GDP growth is expected to remain muted during Q4 FY11 following the moderation in industrial activity. Even the agriculture growth would moderate from the current high levels thereby limiting the overall GDP growth. While private consumption is expected to remain robust, it might not completely offset the lower government expenditure during Q4 FY11.
<b>GDP Growth</b>	8.1 Q4 FY11	8.2 Q3 FY11	
<b>15-91 days T-Bills</b>	6.8%-7.0% Mar-11	6.83% Feb-11	Lower fiscal deficit projection of 4.6% during FY12 and anticipated moderation in food price inflation might continue to support the long term yield especially in the near future. Unabated rise in the crude oil prices, which is likely to trigger another round of domestic oil price hike, might limit the gains. Expected tight liquidity conditions following the advance tax outflows might exert some upside pressures on the short-term yield.
<b>10 year G-Sec Yield</b>	8.1%-8.3% Mar-11	8.30% Feb-11	
<b>Bank Credit*</b>	23.2%-23.5% Mar-11	23.2% Feb-11	

All figures are monthly average

\* Refers to End Period



## An Insight into the Declining FDI Inflows into India

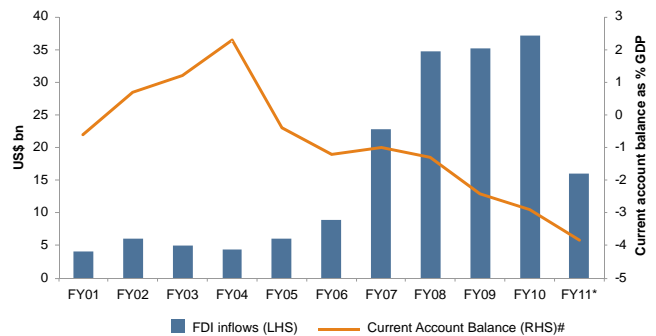
Given the prominent role of Foreign Direct Investment (FDI) in India's growth story so far, the recent decline in the FDI inflows has emerged as a major area of concern and could pose a significant downside risk to growth, if the trend persists. The downtrend in FDI at a time when India's Current Account Deficit (CAD) has mounted to as high as 4.1% of GDP during Q2 FY11 becomes even more daunting. The fact that India is amongst the few Asian economies which witnessed a decline in FDI inflows during 2010 further adds to worries. It is, in fact, intriguing to know that FDI inflows to the South, East and South-East Asia regions, according to UNCTAD, rose by about 18% in 2010 and reached US\$ 275 bn after a 17% decline in 2009, primarily due to booming inflows in Singapore, Hong Kong (China), China, Indonesia, Malaysia and Vietnam. It is therefore important to scrutinise the recent trend in FDI inflows and the underlying reasons for the same.

After recording an average growth of 73.86% between FY05-FY08, the growth in FDI moderated to 0.99% during FY09 consequent to the global economic slowdown. With the gradual recovery in the global economic arena, the FDI inflows in India showed some signs of improvement and grew by around 5.69% during FY10. However, despite improving global economic prospects and robust recovery of the Indian economy, the FDI inflows have largely remained muted during the course of the current fiscal. In fact, FDI inflows had recorded a significant decline of 23.3% during FY11 (Apr-Dec 10) as compared to the corresponding period of the last fiscal. A confluence of factors such as the recent spurt in corruption cases, procedural delays, environmental policy issues, comparatively higher inflation might have affected the FDI investment into the country during the current fiscal. While in general, the global economic prospect seems to have improved in the recent past, the emergence of issues such as debt crisis in the European region is likely to have impacted the investor's sentiment during some parts of the year. This, coupled with the issues prevalent domestically, might affect the long-term FDI flows in India.

From a sectoral perspective, while the FDI inflows in services sector (financial & non-financial) recorded a decline of as much as 24%, sectors such as automobile, metallurgical industries, petroleum and natural gas, chemicals, computer software and hardware witnessed an increase in FDI inflows during Apr-Dec 2010 as compared to the corresponding period of the previous year.

The positive outlook regarding robust domestic demand from the long term perspective, large pool of skilled manpower, government policies such as deregulation of petroleum prices, bidding for oil blocks et al have been playing an instrumental role in attracting FDI in sectors such as automobile, petroleum and natural gas as well as

Moderation in FDI inflows and high CAD - major risk to growth



\* FDI data for FY11 pertains to Apr-Dec 2010 and Current account data for FY11 pertains to Apr-Sep 2010  
Source: DIPP, GoI

computer software. The recent licensing issues in the telecom space and series of corruption cases in real estate financing is likely to have impacted investor's sentiment, thereby limiting the FDI inflows in these sectors. FDI inflows in the real estate and telecom sector registered a decline of 60% and 47% respectively during Apr-Dec 2010 as compared to Apr-Dec 2009. Another important factor that might have weighed down the investor's sentiment in the recent past could be the environment-sensitive policies pursued causing delays to the projects as evident in the recent episodes in the mining sector, integrated township projects, infrastructure projects et al. Moreover, the long standing issues such as lack of adequate infrastructure, land acquisition issues mostly in case of SEZ's and persistent procedural delays continue to limit the FDI inflows in the country. Besides all these factors, foreign investors planning to enter the retail space as well as banking in India or increasing their stake in insurance ventures are still awaiting the required policy changes.

The recent reduction in FDI inflows seems to have gained significant attention amongst the policy markers. As the Prime Minister's Economic Advisory Council highlighted the issue in the recent past, the RBI has taken steps towards examining the issue and articulating solutions thereon by proposing to set up a special committee. Moreover, some of the recent steps such as consolidating all prior regulations and guidelines into one comprehensive document, granting clearance to 24 foreign investment proposals, worth US\$ 304.7 mn are steps in the right direction and would enhance clarity and predictability of our FDI policy to foreign investors. However, India has to go a long way to fully unravel its FDI potential and the government would have to take significant measures aimed at further liberalisation of FDI, thus creating a clean image by tackling corruption, easing the procedural processes and building robust infrastructure to make India an emerging investment hub, going forward.