D&B ECONOMY OBSERVER

Decide with Confidence

Issue 55
November 2011

Contents

View from the top

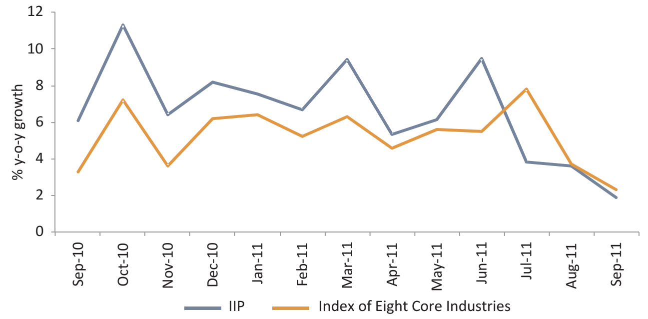
The sharp deceleration in IIP growth over the past few months reaffirms the slowdown in the economic activity. However, the overgrowing concern is the dismal performance in the mining sector which has posted a decline for two consecutive months. The situation needs to be considered seriously and the Government should try to resolve the issues surrounding the project execution in the mining sector otherwise it might impact the production activity severely and also fuel inflationary pressures. One of the primary reasons for the domestic economic slowdown has been the changing inflation dynamics which has sustained the price pressures for a prolonged duration. Elevated levels of inflation and the consequent hardening of interest rates had a moderating impact on the investment as well as the private consumption demand. As per RBI data, with corporate fixed investment already having declined in the second half of FY11 and with only 135 projects sanctioned assistance amounting around ₹ 803 bn during the Q1 FY12, as against 195 projects sanctioned assistance worth ₹ 1,428 bn during Q1 FY11, indicates weak investment activity going ahead.

The point of concern is that while persistence of price pressures in the food articles and manufactured non-food products is expected to prevail during the short to medium term, the global crude oil prices is also expected to remain elevated leading to further imported inflation. This is likely to increase the subsidy burden of the government, whose fiscal balance is already under pressure owing to increased fertiliser and food subsidy on one hand and low revenue receipts (owing to moderation in the domestic growth) on the other hand.

On the external front, the upside risks to current account deficit has increased owing to the slowing global economy and prevailing debt crisis in the Euro region. India's exports growth dropped in Oct-11, growing by only 10.8%, much slower than the average growth of around 52% during Apr-Sept 11. As a result, the trade deficit has inflated to a high of US$ 19.6 bn. This has put pressure on the rupee which is expected to remain volatile with a downward bias in the near term owing to increased imports, the prevailing turmoil in the global economy and deteriorating global sentiments.

The current macroeconomic scenario poses a difficult challenge on the policy front for the government as well as for the RBI. While the government has fewer options to consider any kind of large stimulus package in case the deterioration in the domestic economic activity continues, unrelenting inflation might oblige the RBI to consider another round of rate hike even if it further diminishes the growth momentum.

Rising interest rates and sticky inflation impact industrial activity

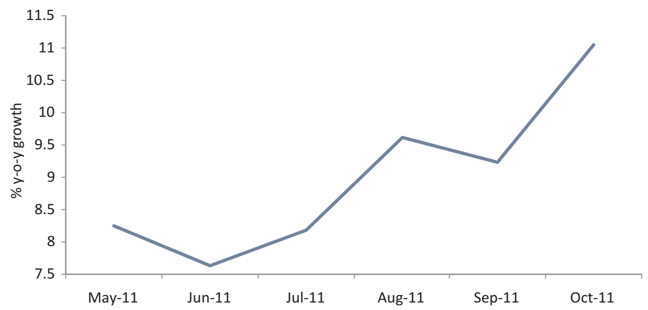


Source: CSO and Ministry of Commerce and Industry

Real Sector

- IIP moderated to a two year low of 1.9% (y-o-y) during Sep-11 as against a growth of 3.6% during Aug-11.
- The mining index declined to 5.6% (y-o-y) during Sep-11 after declining by 4.1% during Oct-11. Manufacturing sector growth moderated to 2.1% (y-o-y) during Sep-11 against a growth of 4.0% during Aug-11.
- Capital goods declined to 6.8% (y-o-y) during Sep-11 as against a growth of 4.0% previous month. Consumer non durables declined by 1.3% (y-o-y) during Sep-11 after declining by 0.5% during Aug-11.
- The index for eight core industries grew by 2.3% (y-o-y) during Sep-11 as compared to a growth of 3.7% during Aug-11.
- Gross direct tax during Apr-Oct 11 stood at ₹ 2,840.8 bn as against collections worth ₹ 2,361.8 bn during the same period previous year.

Food prices continue to march northwards

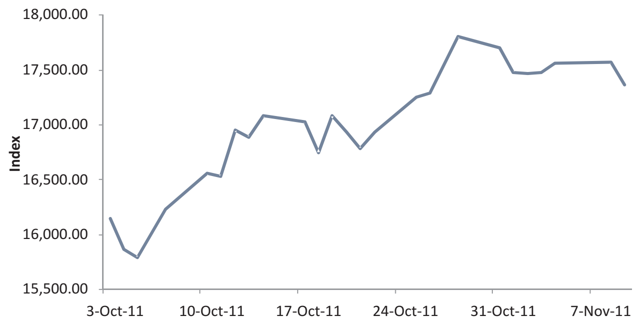


Source: Ministry of Commerce and Industry

Price Scenario

- WPI inflation stood at 9.7% (y-o-y) during Oct-11 depicting a marginal decline over the previous month.
- Primary articles inched downward to 11.4% (y-o-y) during Oct-11 as compared to 11.8% during Sep-11.
- Food articles grew by 11.1% (y-o-y) during Oct-11 as against a growth of 9.2% during Sep-11. Non-Food inflation moderated to 7.7% (y-o-y) during Oct-11 against a growth of 14.8% registered previous month.
- Fuel group registered a growth of 14.8% (y-o-y) during Oct-11 as against a growth of 14.1% during Sep-11.
- Manufactured product prices remained elevated at 7.7% (y-o-y) during Oct-11 almost unchanged over the previous month.

Global pessimism lead to volatile domestic equities

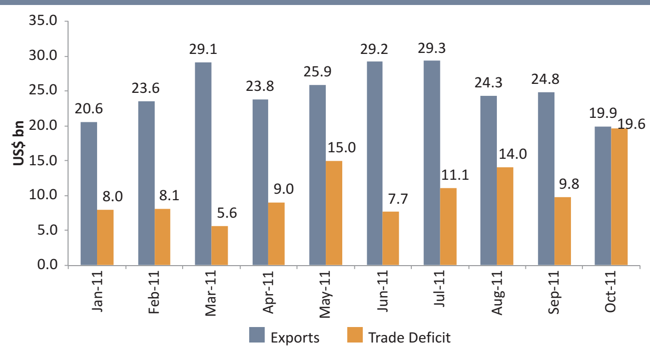


Source: BSE

Money & Finance

- RBI under the liquidity adjustment facility (LAF) increased the repo rate by 25 basis points to 8.50%.
- The RBI decided to deregulate the savings bank deposit interest rate with immediate effect.
- Aggregate deposits increased by 15.3% on 21-Oct-11 as compared to 17.4% during the same period previous year.
- Bank credit increased by 19.4% as on 21-Oct-11 as against a growth of 21.2% in the previous year.
- Food credit and non food credit grew by 46.0% and 19.0% as on 21-Oct-11 as against a growth of 31.1% and 21.1% during same period previous year.

Unfavorable trade balance on declining exports



Source: PIB, Ministry of Commerce and Industry

External Sector

- India's exports rose by 36.4% (y-o-y) to US$ 24.8 bn during Sep-11 while imports rose by 17.2% to US$ 34.6 bn leading to a trade deficit of US$ 9.8 bn. As per provisional data, India's exports rose by 10.8% (y-o-y) during Oct-11 to US$ 19.9 bn while imports rose by 21.7% to US$ 39.5 bn leading to a trade deficit of US$ 19.6 bn.
- Indian oil imports rose by 14.6% (y-o-y) to US$ 9.2 bn during Sep-11 where as non-oil imports rose by 18.2% (y-o-y) to US$ 25.4 bn during the same period.
- The foreign exchange reserves increased to US$ 320.4 bn as on 28-Oct-11 as compared to US$ 305.5 bn as on 1-Apr-11.

Dun & Bradstreet's Macro Economic Forecasts

	Forecast	Latest Period	D&B's Comments
Inflation W.P.I	9.2% - 9.4% Nov-11	9.73% Oct-11	Going ahead the inflationary pressures is expected to moderate from the current levels as the lagged impact of the monetary tightening comes into play as well as due to the moderation in the investment and consumption demand. However, given that the WPI inflation still remains far above the RBI's comfort level and the downside risk from rising global crude oil prices still continue to prevail, the RBI might consider another round of policy rate hike.
Inflation C.P.I (I.W)	9.0% - 9.5% Oct-11	10.06% Sept-11	
Exchange Rate INR v/s US$	49.50 - 49.80 Nov-11	49.26 Oct-11	The exchange rate is expected to remain volatile with a downward bias in the near term owing to increased imports, the prevailing turmoil in the global economy and deteriorating global sentiments.
I.I.P Growth	1.0% - 2.0% Oct-11	1.86% Sept-11	IIP growth is estimated to remain subdued due to the high inflation, low investment activity and further weakening of domestic as well as external demand. These factors along with the prevailing uncertainty in the global economic conditions is expected to take a toll on the overall economic activity over the next two or three quarters.
GDP Growth	7.5% Q2 FY12	7.7% Q1 FY12	
15-91 days T-Bills	8.6% - 8.8% Nov-11	8.41% Oct-11	Credit demand is expected witness further moderation as interest rates continue to inch higher. Higher interest rates and additional government borrowing will lead to higher short term yields and further tight liquidity conditions.
10 year G-Sec Yield	8.5% - 8.7% Nov-11	8.77% Oct-11	
Bank Credit*	18.8% - 19.1% Nov-11	17.9 % Oct-11	

All figures are monthly average

** Refers to End Period*

Efficacy of Social Sector Programs

The Indian economy has become the object of much reverence, optimism and at the same time trepidation over the last few years. Even as various economic indicators are showing healthy trend and India is emerging as one of the fastest growing economies of the world, various dimensions of economic and social disparity-regional, rural-urban, social class or gender have aggravated in tandem. The situation has reinforced the need for corresponding higher priority to the development of social sector- especially healthcare and education. Central Government expenditure on social sector encompassing education, health, housing, rural development, and social security and social protection systems- which directly influence human development - has shown an appreciable increase over the last ten years. The share of social sector expenditure has increased, both as a percentage of GDP and as a percentage of total expenditure. During FY12, social sector expenditure recorded an increase of 17% over the previous year and amounted to 36.4% of the total plan allocation. In this context, it is important to note that state governments continue to bear a significant share of the country's overall public expenditure on social sectors.

Against this background, we now set out to answer two critical questions. a) Where does India stand on its social development outcomes? b) Does it get a good return for the public funds spent on social sectors such as health, education and social protection?

Though budgetary allocations to the social sector have been rising, outcomes are not encouraging enough. Many human development indicators (and especially those related to health) in India continue to remain low in an international perspective and compared to countries with similar levels of development. For instance, India's HDI value for 2011 is 0.547—in the medium human development category-positioning the country at 134 out of 187 countries. The 2011 HDI value is below the average of 0.630 for countries in the medium human development group and below the average of 0.548 for countries in South Asia. Moreover, when the value is discounted for inequality, the HDI value falls to 0.392, a loss of 28.3% due to inequalities in all three dimensions of human development-income, education and health attainments.

While the various flagship development programmes have brought a positive impact in the economy, they continue to suffer from varying degrees of ineffectiveness, poor targeting, and wastage of resources. For instance, the success of Mahatma Gandhi National Rural Employment Guarantee (MGNREGA) scheme has been a mixed bag. The scheme has directly led to the creation of 987 crore person-days of work since inception. In FY11, MGNREGA provided employment to 5.45 crore households generating 253.68 crore person-days. There have also been various flaws in the scheme which has drawn much criticism. Firstly, given the mandatory provisions of the MNREGA of ensuring minimum wages on its entire works, it has had an adverse impact on rural labour markets and the wage structure. Many cases of delays in payment of wages, non-payment of full wages, wages less than minimum wages, and non-compensation for delays in providing work have been observed. At the same time, the success of MNREGA varies from state to state with relatively large successes in states like Andhra Pradesh, Madhya Pradesh and Rajasthan to almost negligible success in states like Jharkhand, Uttar Pradesh and Bihar. There is also considerable variation in the wage paid for manual work across states. The success of MNREGA depends on the awareness of the people and their involvement in planning, delivery, and monitoring through social audits that have been built into the scheme. Providing gram panchayats the necessary training to evaluate and develop projects may also help expedite the process from planning to implementation.

India remains the most privatised health economy in the world with out-of-pocket expenditure accounting for a share of 74% in private health expenditures. The total projected Gross Budgetary Support (GBS) for the Eleventh Five Year Plan was ₹ 1,36,147.00 crore (at current prices). A large proportion of this amount, i.e. ₹. 89,478.00 crore (65.72%) was for National Rural Health Mission (NRHM)- that aims to provide accessible, affordable and accountable quality health services to the poorest households in the remotest rural regions. While there has been some progress being made in reducing Maternal Mortality Ratio and Infant Mortality Rate (IMR), we are still lagging in terms of the IMR target set under NRHM.

To sum up, additional social sector financing per se would not enable India to improve quality and performance of the social sector programmes. There are many factors that need to be addressed for improving effectiveness of social sector policy initiatives and schemes. These include a) removing the variance in efficiency of implementation and program delivery b) getting more reliable and authentic information and data to understand exactly how and where important processes are failing c) improved monitoring and oversight through the use of information technology (IT), d) clearly defining the roles and responsibilities at each level of jurisdiction and finally, strong, vibrant mechanisms for greater monitoring and oversight by the citizens. The efficiency reforms could improve human development outcomes and at the same time protect the fiscal sustainability of social sector programs.

Please send your feedback to Dr Arun Singh, Senior Economist.
Dun & Bradstreet Information Services India Pvt. Ltd., ICC Chambers, Saki Vihar Road, Powai, Mumbai 400 072
Tel: 91-22-28574190 / 92 / 94 Fax: 91-22-28572060 Email: D&BEconomyObserver@mail.dnb.co.in www.dnb.com