



Decide with Confidence

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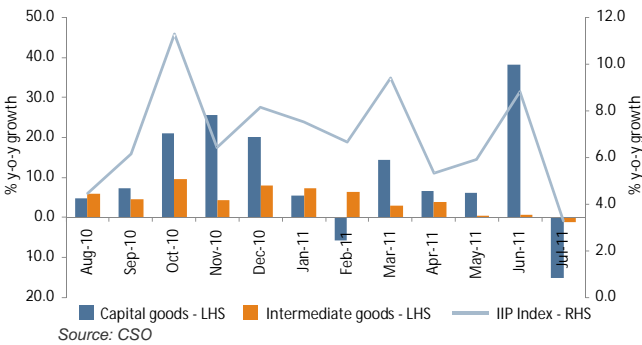
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The prospects of buoyancy in the growth of the Indian economy which was predicted sometime back seems to be fading and increasingly clouded by heightened uncertainty. One of the primary reasons being that the various data sets released within the span of the past few months have failed to provide any indication to the direction or magnitude of the economic activity. The sharp revisions in numbers along with volatility in some data sets are making it increasingly difficult not only to gauge the present scenario but also to estimate future growth prospects.

The latest GDP numbers points to a considerable moderation in the pace of growth of the domestic economy. However, this concern accentuates with the fact that excluding trade, hotels, transport & communication segment, India's GDP have grown only by 5.9%. A closer look at the other components of the services sector reveals that the financing, insurance, real estate & business services segment, which had generally grown by double digits, has been growing below its long term average for the past two quarters. Given the concerns of the growth prospects of the global economy, the prospects of this segment to pick up any further momentum from the current level are not so promising. Further, the growth in the community, social & personal services segment which largely consists of the government activity has been decelerating. Going forward, it is expected to remain subdued given the government's intention for fiscal consolidation. Thus, the loss of momentum in the industrial activity at this juncture appears daunting. While the extremely robust export demand bodes well for the industrial sector, the domestic demand seems to be withering. Demand conditions as reflected by the private consumption expenditure have been on a downward path since the past few quarters. Moreover, the production numbers of the consumer durable sector have been not quite encouraging. On the other hand the investment scenario seems uncertain - the volatility of the capital goods sector in IIP continues to confound, making it increasingly impossible to gauge the investment scenario. However, the six-core infrastructure industries have posted a steady growth since the start of the fiscal year, primarily owing to the growth in the steel and electricity sectors. However, the significant low rate of growth recorded in the manufacturing sector does not bode well for the growth prospects of Indian economy in general and employment scenario in particular. Thus, in a scenario when it is becoming hard to understand not only the magnitude but also the direction of both the investment and demand conditions, we expect GDP to remain subdued during the subsequent two quarters.



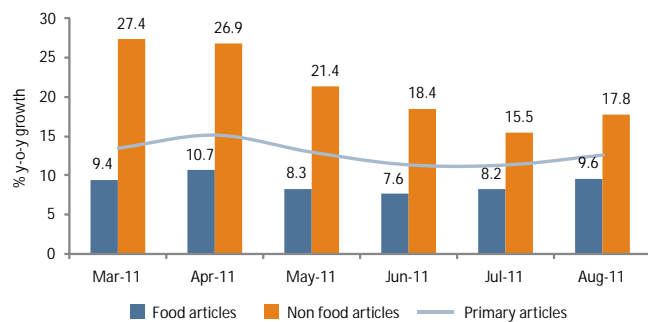
IIP pulled down by the Capital and Intermediate goods sector



Real Sector

- India's GDP growth moderated to 7.7% during Q1 FY12 as against 8.8% during Q1 FY11.
- While the agriculture sector posted a robust growth of 3.9% in Q1 FY12, growth in the services sector remained resilient at 10.0%. However, growth in the industrial sector moderated to 5.1% in Q1 FY12 as against 9.1% during Q1 FY11.
- IIP growth moderated to 3.3% (y-o-y) in Jul-11 as compared to 8.8% in Jun-11 owing to 15.2% decline in the growth of capital goods segment. Also, growth in the manufacturing sector moderated to 2.3% (y-o-y) in Jul-11 against 10.3% in Jun-11.

Primary articles inch up on rising food prices



Price Scenario

- The WPI headline inflation increased by 9.8% (y-o-y) during Aug-11 as compared to 9.2% in Jul-11.
- Primary articles rose by 12.6% (y-o-y) in Aug-11 as against 11.3% in Jul-11 on higher food and non-food prices.
- Food and non food prices increased by 9.6% and 17.8% (y-o-y) in Aug-11 as compared to 8.2% and 15.5% in Jul-11 respectively.
- Fuel index registered a growth of 12.8% in Aug-11 as against 12.0% in Jul-11.
- Manufactured products remained high at 7.8% in Aug-11 after growing by 7.5% in Jul-11.

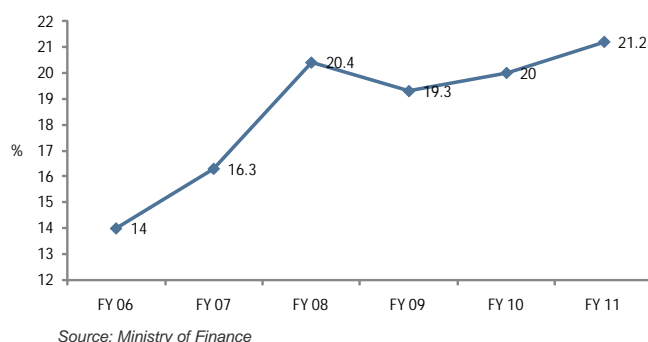
Call money rate on a rise on sequential monetary tightening



Money & Finance

- Aggregate deposits increased by 18.0% (y-o-y) as on 26-Aug-11 as compared to 14.4% in the same period previous year.
- Bank credit increased by 20.7% (y-o-y) as on 26-Aug-11 as compared to 19.4% in the previous year on rising food and non food credit.
- Food credit rose by 55.6% (y-o-y) as on 26-Aug-11 as against a negative growth rate of 3.7% in the previous year.
- While non-food credit increased by 20.2% on 26-Aug-11 as against 19.8% in the same period previous year.
- Inter bank call money rates which were in the range of 4.5%-8.1% on 1-Aug-11 ended at 6.5%-8.1% on 12-Sep-11.

Short term debt to total external debt on a rise



External Sector

- As per provisional data, India's exports increased by 44.2% to US\$ 24.3 bn during Aug-11, while imports stood at US\$ 38.4 bn registering a growth of 41.8%. The balance of trade recorded a deficit of US\$ 14.1 bn.
- India's external debt increased by 17.2% to US\$ 305.9 bn as on end Mar-11 compared to US\$ 261.0 bn during end Mar-10 on rising commercial borrowings and short term trade credits.
- External commercial borrowings rose by 24.7% (y-o-y) to US\$ 88.3 bn during end Mar-11.
- India's total foreign exchange reserves have increased to US\$ 320.8 bn as on 2-Sep-11 as compared to US\$ 294.0 bn at the beginning of Jan (as on 7-Jan-11).



Dun & Bradstreet's Macro Economic Forecasts

| | Forecast | Latest Period | D&B's Comments |
|-----------------------------------|------------------------|------------------|---|
| Inflation W.P.I | 9.2%-9.4% Sept-11 | 9.78% Aug-11 | With inflation not showing any signs of easing despite RBI's aggressive monetary stance, the need for government action to rectify supply-side constraints assume further importance. WPI Inflation is not expected to ease in the near term; D&B has revised upwards its inflation forecast to 7% for Mar 12. Due to sustained high demand-side pressures, D&B expects the RBI to not pause on rates and announce a 25 bps rate increase on 15-Sept-11 with another 25 bps in the policy review after the upcoming one. |
| Inflation C.P.I (I.W) | 8.4%-8.6% Aug-11 | 8.43% Jul-11 | |
| Exchange Rate INR v/s US\$ | 46.90-47.10 Sept-11 | 45.28 Aug-11 | Uncertainty posed by the developments in the US as well as in the Euro region is causing a downward pressure to the rupee. With fresh concerns emanating from the global crude oil front, the rupee is expected to remain volatile with a downward bias. |
| I.I.P Growth | 5.0%-6.0% Aug-11 | 3.29% Jul-11 | The volatility of the capital goods sector in IIP continues to confound, making it increasingly impossible to gauge the investment scenario based on the number released by the Government. IIP growth is expected to remain weak during the coming two quarters as unrelentingly high inflation and hardening interest rates will have an adverse impact on investment and consumption demand. Given that the RBI is expected to continue its monetary tightening as inflation still remains high, the consequent moderation in investment as well as consumption demand is expected to rein in the GDP growth levels going ahead. |
| GDP Growth | 7.7% Q2 FY12 | 7.7% Q1 FY12 | |
| 15-91 days T-Bills | 8.15%-8.20% Sept-11 | 8.20% Aug-11 | Persistent hike in interest rates is likely to keep the yields in the bond market at elevated levels. Credit offtake is expected to remain sluggish as the series of rate hikes has raised the cost of borrowings. This is likely to impact the growth in consumer durable loans. |
| 10 year G-Sec Yield | 8.2%-8.4% Sept-11 | 8.44% Aug-11 | |
| Bank Credit* | 19.5%-20.0% Sept-11 | 20.6 % Aug-11 | |

All figures are monthly average

* Refers to End Period



Upsurge in food prices – an insight

The elevated level of inflation impacted the high growth momentum of the domestic economy as evident in the pace of moderation of the GDP growth numbers over the past few quarters. The fact that inflationary pressures continued to persist for an uncomfortable long period of time and induced primarily by supply side factors had made inflation management a difficult task. The growing concern is that despite the several initiatives taken by the government as well as the RBI, the inflation has shown no signs of moderation and still prevails at very high levels.

Of the primary reasons for this could be that the factors causing the high inflation has been different over the period of time. When the Indian economy witnessed the spectre of high inflation during 2008, it was primarily due to the high global oil prices. Thereafter, decelerating into the negative territory the WPI inflation again reared its head since the end of 2009 to remain in double digits during Mar-July 2010. Looking at the composition of the weighted contribution to the headline inflation reveals that rising food prices on account of unfavorable agricultural supply conditions caused by the deficient South-West monsoon had been the prime driver during April-July 2010. Subsequently, food inflation witnessed a decline barring the months of December 2010-January 2011, while the headline inflation continued to remain at an elevated level driven by non-food and manufactured products inflation. Nonetheless, this decline in the y-o-y growth in the food prices was mainly a base effect as retail food prices continued to remain high indicating that food price pressures were still prevalent in the domestic economy. Further, food inflation shot up to its highest in more than four months in the week ended Aug. 20, which has given rise to great concern.

The rise in the food prices occurred despite a good monsoon and good harvest along with improvement in the availability of most food items which brings to the fore the fact that the monsoons have ceased to play a significant role behind the food price inflation in the recent period. Moreover, food stocks with public procurement agencies had remained above the buffer stock. A breakup of the composition of the food articles contributing to the overall food inflation points that it was primarily due to the protein rich foods whose production is less responsive to the vagaries of the monsoon. The recent NSSO survey results on consumer expenditure of households in India also reveal the trend that within food share of protein-rich items has increased in both urban and rural areas from FY05 to FY10. The rise in income levels with the wage rate increasing in both the rural and urban areas might have caused the shift in the consumption pattern of the household.

Besides protein rich foods the other important segment which had contributed to the food inflation was fruits and vegetables. One of the reasons behind the increase in the prices fruits and vegetables were the lack of proper storage facility for these perishable goods. During November-December 2010, unseasonal rains in certain parts of the country led to significant loss of output of perishable food articles, especially vegetables. Further, the demand supply gaps in the food products especially in the case of protein rich foods such as eggs, meat, fish and frits and vegetables owing to the increase in demand and near stagnant supply owing to lower yield have also been contributing to the increase in their prices.

One of the other reasons could be the significant increase in the export of oil meals. Given that the Indian dairy and poultry industry demands fodder as animal feed which is met through oil meals, it needs to be ensured that the domestic requirements are met, which would ease off some pressure in the input cost of the Indian dairy and poultry industry.

Currently, manufactured food products inflation, which declined sharply during FY11, has reversed its trend during the past few months. The rise in prices of edible oils, milk products and tea & coffee also points to the fact that the past increases in primary food prices are getting reflected in manufactured food price increases, with a lag (according to a report by the RBI).

While prices pressure from the cereals and pulses have remained on the lower side, given the increase in the production, the revision in Minimum Support Prices undertaken by the Government recently might add to the upward pressure on these articles going ahead. Moreover, the significant surge in the fuel prices has also added to the input cost of the food production of the country.

The way forward

- Efforts towards suitable infrastructure for the perishable fruits and vegetables needs to be initiated.
- Encouraging instruments like weather insurance and crop insurance may help mitigate risks associated with weather, attack by pests, insects etc.
- Foreign trade policies should favor the residents through encouraging exports during a good crop year to avoid wastage. However, during shortages domestic demand should be met before exporting food articles.