MONTHLY MONITOR

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GDP growth for 2008-09 revised downwards to 6.4%

For 2009-10, GDP growth expected to be at 5.8%

Stimulus packages yet to show anticipated results

Dip in exports and capital outflow to prolong the recovery

Impact of crisis is expected to be higher in 2009-10

Cyclical slowdown further aggravates economic slowdown

Policy responses to have lagged impact

Economic outlook for 2009-10

The advance estimates for the year 2008-09 shows that India's GDP would have registered a growth of 7.1% against 9% in 2007-08. (It may be noted that DSE-IEG macroeconometric exercise was the first to predict a growth of 7% for the year 2008-09 in September 2008 itself). As the crisis unfolded and its impact on India's economic activity turned out to be much severe than it was predicted in September 2008, our GDP growth forecast for the year 2008-09 has been revised downward to 6.4%. This downward revision is largely due to sharp fall in exports growth and also due to larger than expected outflow of foreign capital that reduced the overall business sentiments and also the investment activity in the economy. This resulted in decline in the growth of manufacturing, construction activity and other trade, business and financial services. Although fiscal and monetary stimulus packages were introduced, it is expected that these measures (particularly the monetary measures) would have a significant lagged impact and might not have helped the growth in 2008-09.

Based on our macroeconometric exercise, the impact of global economic crisis on India is going to be higher in 2009-10 compared to the previous year. As noted above, the transmission mechanism of crisis to economy is through fall in external demand and foreign capital outflow. Unlike in other industrialized nations, in India this crisis initially affected the real sector by reducing the external demand. Hence, after achieving a robust growth for the four consecutive years, India's export growth started showing negative trend since October 2008 and is expected to continue for the rest of the year due to recessionary situation in most of the industrialized nations. This adverse effect have transmitted to the financial markets and created capital shortages, and, hence, decline in private investments.

Against this, the macroeconomic policy response from the fiscal and monetary side is indeed expected to help the economy to recover from sharp fall. But, as the trends show, it would have a minimal impact as monetary policy transmission appears to take

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Monetary transmission slower than anticipated

longer period than anticipated due to unprecedented fall in the business confidence.

Agriculture growth to be robust

Low growth to continue until 2010-11

Overall, the GDP growth for the year 2009-10 is expected to be 5.8%. This growth is largely due to domestic factors following introduction of policy responses such as fiscal and monetary policy stimulus and with expected robust agriculture growth, which is projected to grow at around 3.5 to 4%. But getting back the economy to 9% growth depends largely on the revival of the global economy. As the global recession is expected to continue till the end of 2010 (OECD projects a growth of -3.2% in 2010 for the OECD region), India could get back to high growth path only after 2010-11.

Swine flu to hamper global recovery

International business in the emerging market economies to fall

Swine flu is expected to further dampen-down the international business through decline in factor mobility. This could restrain from speedy recovery of the global economy, in particular the emerging market economies such as India and China that are expected to lead the global revival. For India, this could affect both services and tourism sector and, hence, could delay the upturn in the growth of industrial output.

Other stories

WPI inflation continue to be subdued

Negative inflation expected

Stimulus packages to ensure 4-4.5% inflation by March 2010

The WPI inflation remains subdued at 0.26% in April 2009. But the prices of primary articles and sugar are growing at a higher rate. Decline in the aggregate demand, fall in international prices and high base effect must have led to this low inflation level. Due to same reasons we expect negative inflation in the coming months. But, following stimulus packages, we do expect inflation to start rising and reach to its threshold level of 4 to 4.5% by the end of 2009-10.

Industrial growth remains negative

This is due to crisis and cyclical downturn

Industrial growth continues to be negative. Fall in the external demand and the presence of strong cyclical movements, which is moving downwards, could have pulled down the industrial growth. But there are signs of recovery as there is rise in the growth of capital goods and consumer durable goods output. This shows that the downward cycle is expected to bottom-out any time from now.

Money supply growth declines

bank credit and forex assets both declines

Due to fall in both banks' credit to commercial sector and in the net foreign exchange assets with banks, money supply growth has come down to 18.6%. Recent reduction in policy interest rates and large fiscal expansion is expected to increase the money supply growth in the coming months. On the interest rates side,

Lending rates are sticky	although policy rates have been reduced, the lending rates are still sticky, making the monetary policy changes less effective.
Forex reserves increasing ***NRI remittances and relaxation of ECB and FDI norms help forex accretion***	Foreign exchange reserves have started increasing. Currently, it is at US$ 253 billions. Rise in the NRI remittances and narrowing of trade deficits appears to have restrained the reserves outflow. This has also been augmented by the FDI flows following relaxation in ECB and FDI norms. This rise in reserves appears to have led to exchange rate appreciation. We expect further appreciation of exchange rate in the coming months.
Exports growth continued to be negative ***This is largely due to base effect and global recession*** ***Imports growth also turned out to be negative*** ***Trade deficit narrows***	For the fifth consecutive months, exports growth turned out to be negative. This could be due to sharp fall in the global demand and also due to high base effect. Exports incentive that was provided in later part of 2008 appears to have no impact on exports. On the other hand, imports growth also turned out to be negative. Fall in the imports of intermediate goods, following industrial slowdown, and in oil imports must have led to this negative growth. We expect both exports and imports to register negative growth in the next three months as well.

IEG forecasts

Variables	Latest Information available	Forecast for next Three months
Inflation rate (WPI)	0.26 % as on 11th April, 2009	-0.5%, -0.08% and 0.21%
Inflation rate (CPI)	9.6 % in February 2009	9.13%, 8.68% and 8.25%
Growth rate of IIP	-1.2 % in February 2009	-0.97%, 0.5% and -0.19%
Growth rate of M3	18.6 % as on 27th March 2009.	Expected to decline to 18.4%
Prime lending rate	11.50-12.50% as on 4th April 2009.	Expected to decline further
Re/$ exchange rate	40.93 on 24th April 2009	Appreciate to 49 by July 2009
Forex reserves	US $252.98 billions as on 10th April 2009.	Expected to be around US$ 255 billions by July 2009
FII inflows (Net)	US$ -1085 millions in February 2009	FIIs to be negative
Growth rate of exports	-21.7 % in January 2009	-11.2% (average)
Growth rate of imports	-23.3% in January 2009	-21.6% (average)

Inflation continues to decline

Primary articles prices still growing

Fuel group, edible oils and iron & steel show negative inflation

Negative inflation imminent largely due high base effect

Fiscal and monetary stimulus to bring back inflation to its threshold level

IIP growth negative in Feb 2009

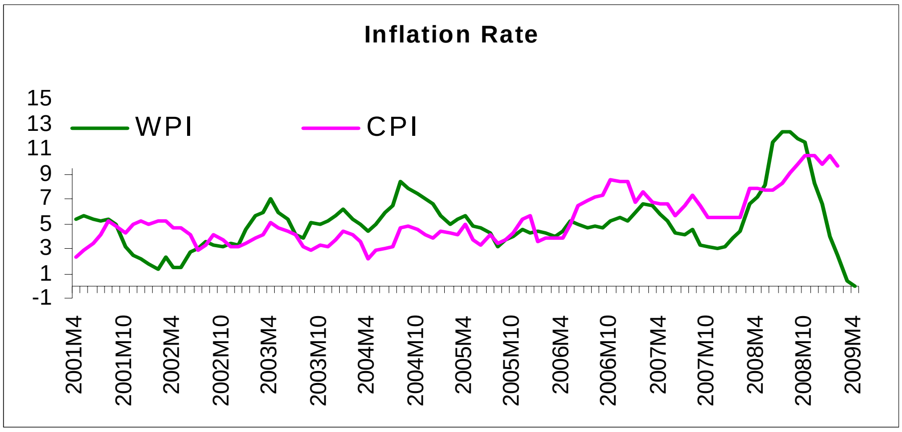
Inflation

The WPI inflation rate continues to be below 1% for the second consecutive month and staring at deflationary situation. The recent data show that the inflation stood at 0.26%. This low inflation was largely due to the reduction in the fuel group prices (which increased at -6.1% and has a weight of 14.23) and due to the high base effect. But the prices of primary articles are still growing at 3.5%, which could be due to supply shortages (agricultural output growth in third quarter of 2008-09 estimated to be at -2.2%). Further, the prices of sugar have increased sharply by 17%, while the edible oils and iron & steel prices have grown at -10.2% and -18.4% respectively. Fall in the aggregate demand, following crisis, high base effect and decline in the international prices must have led to fall in overall inflation. Going forward, due to same reasons, it appears that WPI inflation could turn negative for few weeks in May-June also. (On the other hand, the CPI inflation also came down to single-digit of 9.6% in February 2009).

In terms of policy response, although the impact of credit policy changes on inflation could take some more time, the fiscal policy changes is expected to restrain the economy from experiencing prolonged negative inflation. It is also necessary to take some more measures to bring the inflation to its threshold level of 4 to 4.5% by the end of March 2010.

Forecast:

The WPI inflation forecast for the next three months to be -0.5, -0.08 and 0.21% respectively.



Industrial Production

Slowdown in the Industrial output growth continues. In February 2009, the IIP growth stood at -1.2% against 9.5% in the same period in 2008. For January 2009, the growth has been revised to 0.3% against the initial estimate of -0.5%. This negative growth has been

Both manufacturing and mining show negative growth

But growth of capital and consumer durables register robust growth

contributed by both manufacturing and mining sectors, which registered a growth of -1.4% and -1.6% respectively. On the Use-based classification, consumer non-durable goods growth continues to be negative at -5.5%. But the sharp rise in capital goods output growth by 10.4% (cumulative growth of 17.7% in April-February 2008-09) and 5.7% growth in consumer durable goods show that the industrial sector showing some recovery signs.

Downward movement in industrial cycle and decline in external demand leading to industrial deceleration

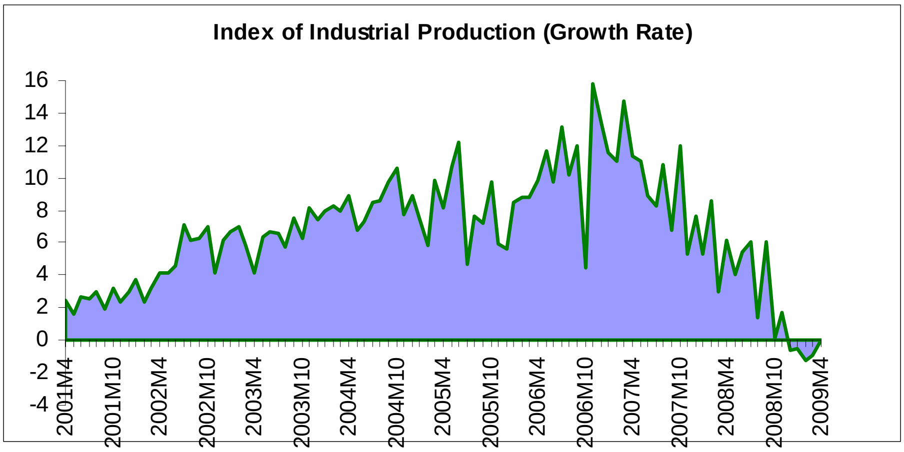
Monetary policy actions has not shown desired results

As we have said in our earlier issues, the industrial sector has slowed down much before the global economic crisis following. This is largely due to the presence of strong cycles, which after moving upwards since 2002, was moving downwards since the end of 2007. But this cyclical slowdown was further aggravated by the global economic crisis, which has led to decline in the demand (both domestic and external) and negative sentiments in the markets. Continuation of these conditions could make the industrial recovery difficult. But the recent domestic policies, such as fiscal and monetary stimulus packages, could reinvigorate the domestic demand and, hence, the industrial activity. But this would not be before June 2009. In terms of monetary policy changes, we reiterate that it is the credit channel rather than interest rate channel that is more effective in India. This could be substantiated based on the recent stickiness in the prime lending rates despite reduction in the policy interest rates. Hence, industrial recovery also depends on the bank lending behaviour.

Recovery depends on bank's response to monetary policy

Forecast:

Based on the available information we forecast the IIP growth rate for the next three months to be -0.97%, 0.51% and -0.2%.



Money and Credit

Fall in credit off-take and net forex reserves with banks has led to decline in money supply growth

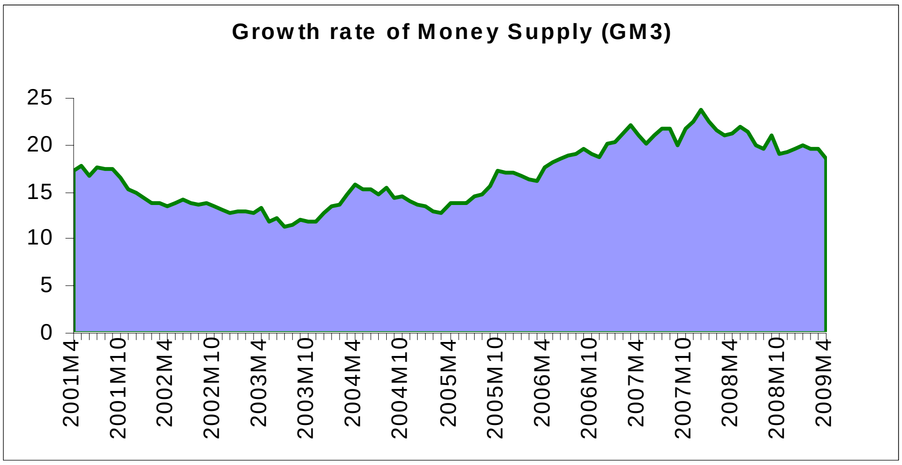
Money supply growth declined to 18.6%. This drop is largely contributed by the fall in both credit off-take and the net foreign exchange assets with the banking sector. The decline in the demand for credit from the commercial sector has led to fall in the growth of credit to 16.9% against 20.9% a year ago. Similarly, the foreign exchange assets growth has declined sharply from 42% to mere 1.4%. Reduction in the policy interest rates, which is expected to result in decline in the lending rates and lead to credit demand, appears to have no impact on the money supply even after six months. This only confirms our view that the interest rate channel in India is weak. But the three fiscal stimulus packages, which could result in double-digit fiscal deficit/GDP ratio, would retain the money supply growth at its current level. Further, it would also depend on the response from the commercial banks and also on the market sentiments. The recent trend of reduction in PLR by some major banks is a positive step towards increasing efficiency of monetary policy.

No impact on interest rates reduction in on money supply

Forecast:

We forecast the growth rate of money supply (M3) to be around 18.5% in the next three months

High fiscal stimulus might lead to monetization of deficit



Interest rates

The decline in the inflation rates and deflationary expectations exerted downward pressure on the interest rates for quite some time. But the full impact of reduction in the policy interest rates is still to be reflected in lending rates. With the inflation rates at its lowest level, the real interest rates appear to be double-digits, which could discourage both consumption and investments. Hence, to revive the economy, there is a downward pressure on the real interest rates. But, in our view, although there is a room for further reduction in policy interest rates as the interest rate cycle is yet to be bottomed-out, it would be wise to hold it until the previous reductions are transmitted to credit demand through reduction in lending rates. Further, as there is little option in terms of fiscal stimulus, any macroeconomic policy to revive the economy could largely depend on the monetary policy, in particular the interest rate policy.

Lending rates are sticky despite cut in policy rates

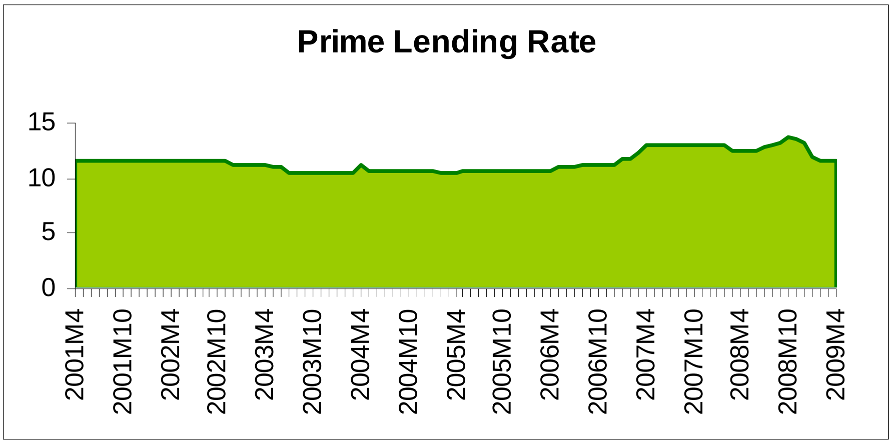
Interest rate cycle yet to be bottomed-out

Deflationary expectations to push rates downwards

There is further room for cut in interest rates

Forecast:

Based on the data up to April 2009, we forecast that prime lending rates to decline further.



Exchange rate

Exchange rate appreciates

Narrowing trade deficit and rise in FDI inflows has strengthened the Rupee

Expect the Rupee to appreciate further to 49

After experiencing volatility following the international financial turmoil, the Rupee/Dollar exchange rate appears to be relatively stable in the range of 49 and 50. The decline in the export earnings and the outflow of short term foreign institutional investments seems to increase the pressure on the Rupee in the short term. But the recent policy measures such as relaxation of ECB and FDI norms, which have resulted in surge in the FDIs and more foreign capital inflow, we expect that the Rupee would not depreciate further. In addition to this, the short term increase in the NRI funds and the sharp fall in the imports that has brought down the trade balance to –US$4.9 billions in February 2009 compared to –US$6.1 billions in January 2009 is also expected to restrain the Rupee from further depreciation in the short term. In the medium term, the exchange rate movements could depend on the behaviour of foreign investments. Overall, we expect the Rupee to appreciate to 49 by the end of June 2009.

Forecast:

The Rupee/US Dollar exchange rate is expected to be around 49 in the next three months.

Foreign Exchange Reserves

Forex reserves increases

Swine flu could restrain forex accumulation to some extent

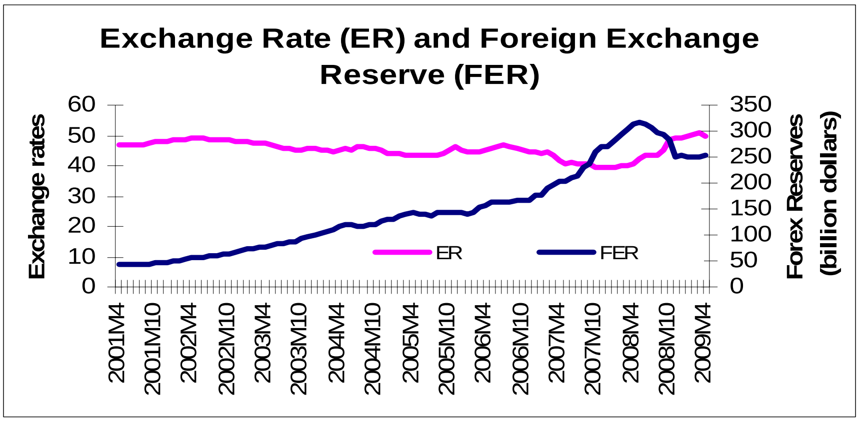
The foreign exchange reserves, after declining sharply by nearly US$ 55 billions since September, have shown some accretion. By 10th April 2009, the reserves stood at US$ 252.98 billions. Two factors must have contributed to this accretion: the fall in the trade deficit and the rise in foreign investments following changes in ECB and FDI norms in February 2009. This also helped by the rise in NRI funds that are the result of employment loss in the

Rise in NRI funds and relaxation of FDI norms could help forex accretion further

Gulf region following crisis. Due to same reasons we expect further accretion of reserves. But the re-look at the recent changes in FDI norms, although warranted, and sustained bearishness in the global financial markets might restrain huge forex accumulation as risk perception is playing a major role in the foreign exchange market behavior than the market fundamentals.

Forecast:

Forex reserves expected to reach at US$ 255 billions by the end of July 2009



Foreign Institutional Investment

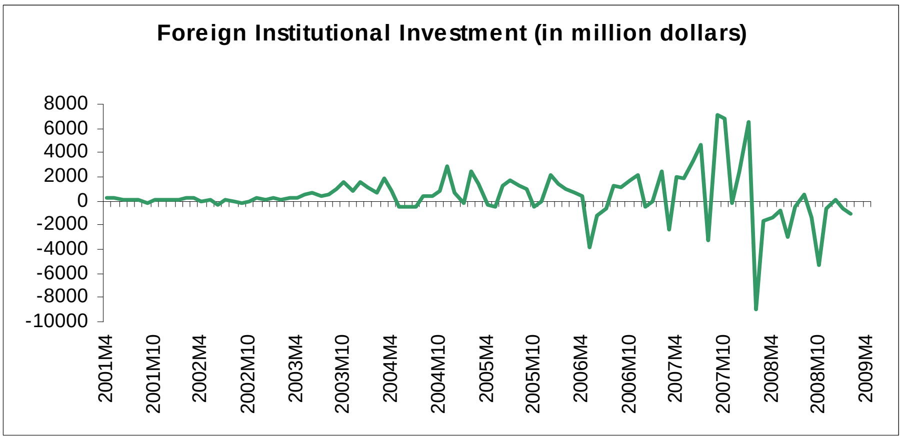
FIIs continue to be net sellers

FII outflow in April-February at US$14 billions

Improvement in stock indices to attract FIIs

Swine flu could impact the FII inflows substantially

Outflow of the foreign institutional investments continue. Recent data on FII investments for October 2008 shows that the FIIs were net sellers in the tune with US$ 1.085 billions. Since April 2008, the FII outflow is around US$ 14.108 billions. As said earlier, although there was shot-term liquidity constraints in the international financial markets, the sentiments and the risk perceptions seems to be a major factor determining FII investments. Recent recovery in the domestic stock indices with not so negative sentiments on Indian economy could encourage FII investments to some extent. But it largely depends on the future economic outlook together with the prudent fiscal and monetary policy measures.



Exports growth continue to be negative for fifth month

Large base effect and recession in developed nations dampening external demand

Imports growth at -23.3% in February

Fall in intermediate goods imports, oil bill and Rupee depreciation led to this fall

Trade deficit narrows and expects to narrow further

Forecast:

Based on the data up to February 2009, we expect the FII to be net sellers in the next three months.

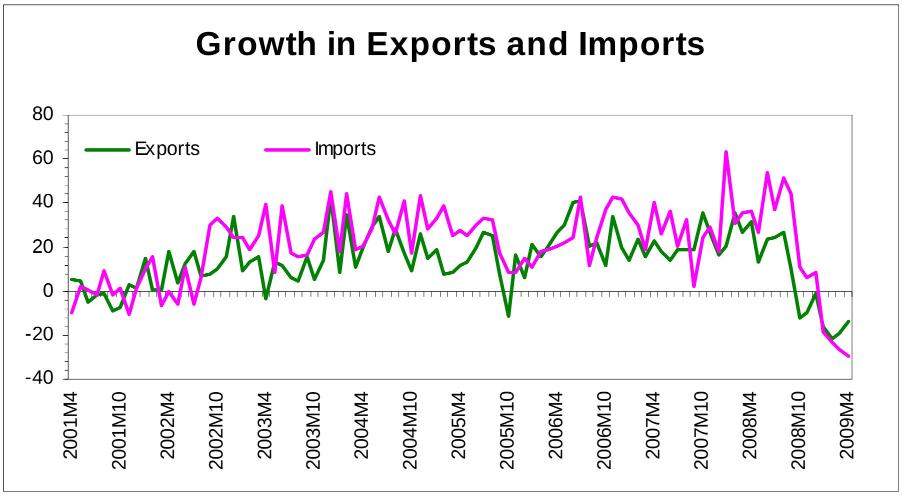
Exports and Imports

For the fifth consecutive month, the export growth turned out to be negative. In the month of February 2009, the exports registered a growth of -21.7% against robust growth of 35.2% in the same period last year. Overall, for the April-February period, exports grew at 7.3%. Sluggishness in the external demand following recessionary trends in industrialized nations, large base effect and cyclical downturn must have resulted in sustained negative growth of exports. Due to same reasons, we expect decline in exports to continue for the next three months. As we have been saying for some time, the sops given to exporters in December 2008 appears to have no impact on the export performance.

On the other hand, growth of imports has also negative growth for the second consecutive month. For February 2009, imports growth was at -23.3%. But overall growth for the period April-February is still at a robust level of 19.1%. Decline in the demand for intermediate goods imports, sharp fall in the oil import bill and huge base effect appears to have resulted in this negative imports. This has also been accentuated by import restrictions on certain items and the weak Rupee, which has touched to its highest level in this period. This negative trend in both exports and imports has resulted in narrowing of trade deficit to -US$4.91 billions and is expected to decline further.

Forecast:

Based on the data up to February 2009, we expect both exports and imports growth to be negative at around -11.2% and -21.3% respectively in the next three months (average).



Note:

The forecasts that are presented in this document are based on the time series model namely Vector Autoregression model (VAR). Each variable has an independent model. This is based on monthly data from April 1993 onwards upto latest information available. The lag length for each VAR model is chosen with the help of Akaike Information Criterion (AIC). We estimate and forecast the VAR models by using Micro FIT software. More details is available at "A Short-term Time Series Forecasting Model for Indian Economy" available on our institute website at **http://www.iegindia.org/dis_bhanu_72.pdf**

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