



सत्यमेव जयते

MONTHLY MONITOR

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April 2011

Industrial growth picks up

Highlights

The annual growth of Index of Industrial Production for the month of March has come out at 7.3 percent versus 3.6 percent in February 2011, and is largely explained by a high rise of 12.9 percent in the growth of capital goods. high fall of 18.6 percent in the growth of capital goods. Whereas the capital goods decelerated at 18.6 percent in February and 18.1 percent in January 2011. In contrast, the capital goods increased at a whopping 63.0 percent in July 2010. Though industrial activity is showing the signs of pick up again the inflationary concern remains.

WPI inflation falls marginally

The year on year WPI inflation was 8.66 percent in April, marginally lower than the 9.04 percent for March 2011, and is largely explained by the high base effect. The inflation has almost become sticky at around 8.5 percent since August 2010. The rapid growth of GDP, the slow growth of agriculture and the low base effect explains this high inflation for the last many months. The recent surge in oil prices also has started putting pressure on inflation. The withering of the low base effect and the continuing monetary tightening of RBI though at a slower pace are putting some downward pressure on inflation.

CPI inflation is sticky at same level

The annual growth in all India Consumer Price Index Number for Industrial Workers remained at the same level in March as in February 2011 at 8.82 percent. There was a marginal reversal in the annual growth in all India Consumer Price Index Number for Industrial Workers which went down to 8.82 in February from 9.30 percent in January 2011 and 9.47 percent in December, 2010. However, the much sensitive food Inflation was up at 8.29 percent in March against 7.65 percent in February and the high 10.22 percent in January, 2011.

Rupee depreciated marginally

The continuous flow of FIIs into Indian stock market and the strong growth of Indian economy in recent months have assisted in strengthening the Indian rupee. In recent months the rupee is fluctuating in a narrow range. The monthly average value of dollar was 44.62 till May 20 as against 44.78 till April 13 and 45.18 till March 17, 2011.

Exchange Reserves falls marginally

Foreign exchange reserves went up almost progressively from US\$ 273.72 billion in May 28, 2010 to US\$ 307.49 billion on May 13, 2011. This is a substantial progress from months back when reserves reached below 250 billion mark, though it is away from the peak of 314.61 billion of May 2008. These impressive figures clearly show the foreign investors' confidence about India's long term growth prospects.

Exports growth keeps momentum while trade deficit is up

The export growth was at 34.4 percent in April, led by a 109 percent growth in engineering goods, maintaining the momentum from the previous months' growth of 43.9 percent in March and 49.8 percent in February 2011.

Imports grew by 14.1 percent in April, 17.27 percent in March, 21.61 percent in February and 13.1 percent in January, 2011 as against a contraction of nearly 11 percent in December 2010. This rebound is mainly due to the non-oil imports showing pick up in internal demand. The trade deficit is up at 8.9 billion in April 2011. It was down to US\$ 5.61 billion in March 2011 against US\$ 9.37 billion a year ago. The deficit is a concern though it is increasing at a slower rate due to the lower growth of imports.

IEG FORECAST

Variables	Latest Information available	Forecast for next three months
Inflation rate (WPI)	8.66% in April 2011	8.47%, 8.24%, 7.93%
Inflation rate (CPI)	8.82% in March 2011	8.74%, 8.69%, 8.56%
Growth rate of IIP	7.3% in March 2011	5.73%, 5.48% , 4.84%
Growth rate of M3	16.9% on May 6, 2011	16.82 %,16.70%,16.71%
Re/\$ exchange rate	44.62 monthly average till May 20, 2011	45.07, 44.97, 44.68
Forex reserves	US\$ 307.49 billion on May 13, 2011	\$309.5, \$310.43, \$311.53
FII inflows (Net)	US\$ -651.93 million for one month till May 20, 2011	Inflows to pick up momentum in the next three months
Growth rate of exports	34.4% in April 2011	Average for the next three months 28.12%
Growth rate of imports	14.1% in April 2011	Average for the next three months 11.6%

WPI inflation down marginally

Inflation

The year on year WPI inflation was 8.66 percent in April, marginally lower than the 9.04 percent for March 2011, and is largely explained by the high base effect. In April 2010, the inflation was 10.88 percent against 10.23 percent in March, the same year. Since August 2010 when the new series was introduced, the inflation was always higher than 8 percent, except in November when it was 7.48 percent. The new WPI index tracks 676 commodities in contrast to the old index which was based on 435 commodities. The rapid growth of GDP, the slow growth of agriculture and the rise in crude prices explains this high inflation for the last many months.

In March 2011, the primary articles index with a weight of 20.12 percent rose by 2.2 percent while the index for fuel, power, light and lubricants with a weight 14.91 percent was up by 1.1 percent, and the index for the principal sector, the manufacturing products with a weight of 64.97 percent was up by 1.04 percent over the previous month.

Since last many months, though accelerated food price increase, the increase in input prices for manufacturing, the increasing trend of crude prices and the short-term falling trend of rupee were putting an upward pressure on inflation, the withering of the base effect, the continuing monetary tightening of RBI and the other government measures were putting a downward pressure on inflation. Recently the food prices have started cooling down though the manufactured goods inflation is up indicating the emergence of a demand-pull inflation. The middle east crisis along with the recovery in the western economies has caused a sharp rise in oil prices. On the positive side, the area under Rabi crops has gone up and the monsoon forecast for the 2011-12 agricultural year is positive. On balance, the inflation is likely to marginally go below the psychological 8 percent mark in the next three months.

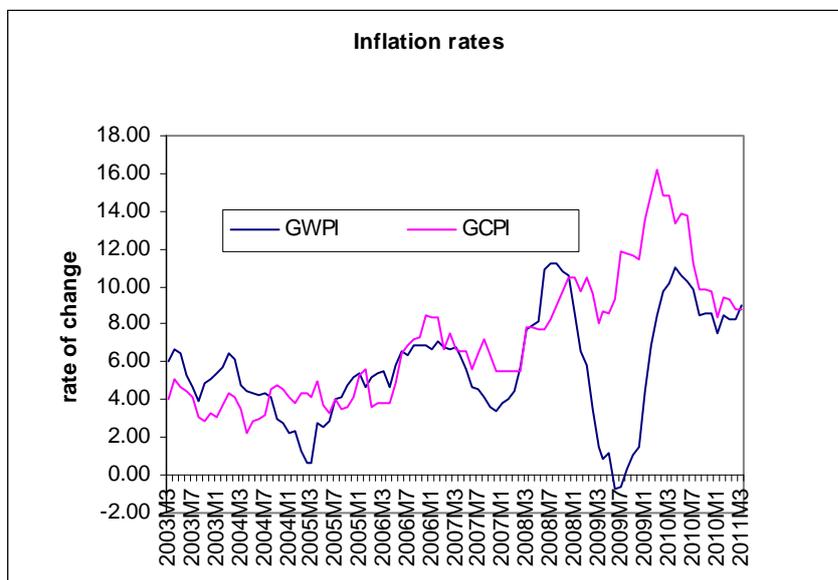
CPI inflation is sticky at the same level

The annual growth in all India Consumer Price Index Number for Industrial Workers remained at the same level in March as in February 2011 at 8.82 percent as against 9.30 percent in January 2011 and 9.47 percent in December, 2010. However, the much sensitive food Inflation was up at 8.29 percent in march against 7.65 percent in February and the high 10.22 percent in January, 2011. The CPI inflation was 8.33 percent in November, 9.88 percent in August 2010, 11.25 percent in July, 13.73 percent in June, 13.91 percent in May and 13.33 percent in April, 2010. The gap between inflation rates as measured by the wholesale price index and as measured by consumer price index is explained by the higher weightage given to primary products and food items in CPI, whereas WPI covers a wider range of the outputs of various commodities. It is forecasted that the growth rates in CPI will remain around the same in the next three months as in November, mainly, due to the rise in food prices.

Industrial growth is up

Forecast:

The WPI inflation forecasts are 8.47 %, 8.24 %, and 7.93 % for May, June and July 2011 respectively. The CPI inflation forecasts are 8.74%, 8.69% and 8.56% for April, May and June 2011 respectively.



Industrial Production

The annual growth of Index of Industrial Production for the month of March has come out at 7.3 percent versus 3.6 percent in February 2011, and is largely explained by a high rise of 12.9 percent in the growth of capital goods. The IIP grew at 3.6 percent in February, 3.7 percent in January 2011, 1.6 percent in December, 2.7 percent in November, 10.8 percent in October, 4.4 percent in September, 5.6 percent in August, 13.8 percent in July, 7.1 percent in June, 11.6 percent in May, 17.6 percent in April and at 13.5 percent in March 2010. The index recorded high growths of 17.6 per cent in December 2009, 16.7 per cent in January 2010 and 15.1 percent in February 2010.

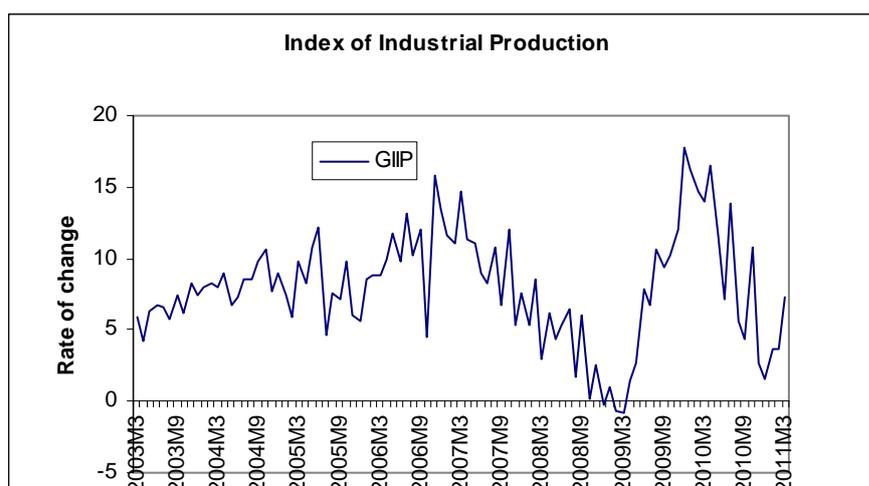
The uptrend in the industrial activity is getting consolidated. The revival in demand supported by the low base for the year 2009 is able to deliver this continuous positive growth. However, the pace of growth got tapered off as the low-base effect wears off and the impact of rate hikes and withdrawal of stimulus picked up. Though global recovery is picking up, the inflation pushed rate hikes will pull the growth down. However, the forecast of a normal monsoon will provide a great relief. Recently, the IIP growth has become extremely volatile. The high growth in advance tax collection and exports is a positive sign for industrial growth. The middle east crisis and the natural disaster in Japan are worrying signs in short run. The IIP growth is likely to be around 3.8 percent in next month.

The Mining, Manufacturing and Electricity sectors for the month of March 2011 grew at 0.2 percent, 7.9 percent and 7.2 percent, respectively, as compared to the same month in the previous year. It is a good sign that out of the seventeen industry groups, thirteen have shown positive growth during March. Industry groups like 'Leather and Leather & Fur Products', 'Other Manufacturing Industries' and 'Food Products' have increased at very high rates of 28.6 percent, 25.6 percent and 18.4 percent, respectively, and have helped the IIP to maintain its positive trend. The mining sector may not pick up in the short to medium run as environmental issues may take time to resolve. Similarly, land acquisition issues also affecting the industry sector as whole. Even though the domestic demand remains strong and the uncertainty associated with the global demand is reducing, unless the supply constraints are progressively reduced the growth may retard in the Manufacturing sector. The crisis in the middle east is adding to the problem of high oil prices.

In March 2011, the annual growth rates in Basic goods and in Intermediate goods are 4.3 percent and 5.4 percent, whereas Capital goods turned around and increased by a high 12.9 percent. This is a good sign for sustaining the overall growth rate in the economy especially when the output gap is closing up in the economy. The Consumer goods rose at 7.7 percent while the Consumer durables grew at 12.3 percent and Consumer non-durables increased at a high 5.7 percent.

Forecast:

Based on the available information we forecast the IIP growth rate for the next three months to be 5.73%, 5.48% and 4.84% for April, May and June 2011



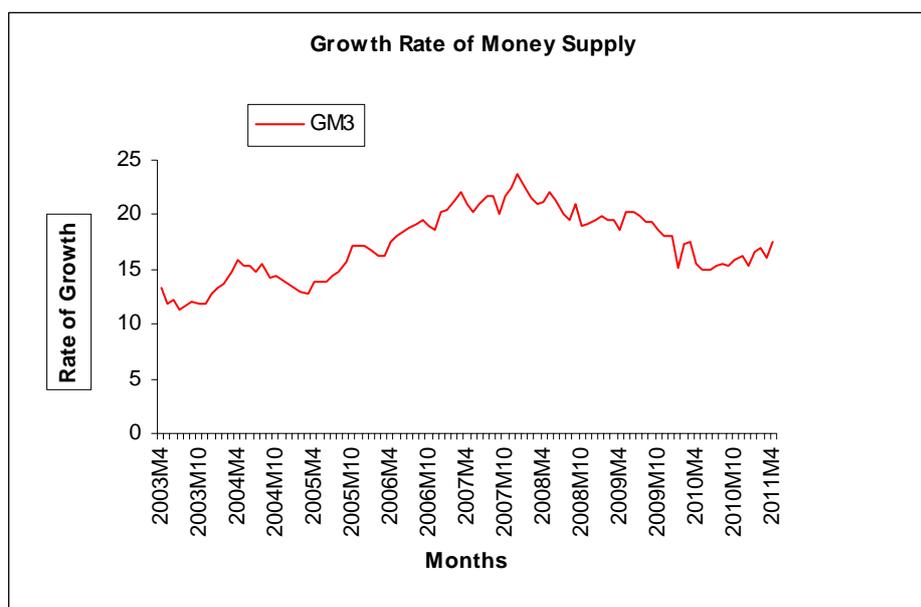
**Money supply
down at 16.9
percent**

Money and Credit

As on May 6, 2011, Money supply grew annually at 16.9 percent as against 16.0 percent on March 25. On January 14, 2011, it grew at 16.6 percent. In 2010, it grew at 15.0 percent in December 17, 16.2 percent in November 19, 15.8 percent in October 8, and 15.6 percent in September 10. Though the monetary tightening of RBI has reduced the liquidity in the system, the picking up of credit off take has helped the money supply to increase. The expansion in money supply is contributed by the net credit to the Government increasing at 17.4 percent and credit to commercial sector at 21.7 percent. Overall credit uptake has been high in comparison to last year. The FIIs have started withdrawing money from India due to the euro zone problem and the prospective stimulus withdrawal in USA. However, this is a short run problem. The government has increased the FII limits recently. The money supply is forecasted to grow at more than 16.5 percent for the next three months.

Forecast:

The forecast for the growth rate of money supply (M3) is 16.82 %, 16.70% and 16.71% for June, July and August 2011



Interest rates

As the positive signs of the revival of the economy is sustaining itself and inflation has become sticky at an unacceptable level, the RBI is slowly withdrawing from its low policy rates regime and the trend is going to continue, even though at a slower pace, given the inflationary expectations in the economy. The RBI has already raised its repo rate by 250 basis points since March 2010 to 7.25 percent. The reverse repo rate is now 6.25 percent. The rise in food prices, though has started cooling down, has already caused the manufacturing prices to go up.

Interest rates are in upward spiral

The inflation rates (WPI) are down from the double digits, however, the rates are still high and the inflationary expectations also continues to be high as the oil prices has gone up sharply due to the middle east crisis as well as revival in western economies. The growth momentum in the economy backed by domestic demand is putting pressure on prices. The prime lending rates are also seeing upward revision both due to the continuous upward revision of policy rates, upward revision of deposit rates and the uncertainty in the global scenario. In the medium term, increases in prices and GDP will increase the demand for money while monetary tightening by RBI will reduce the supply putting further pressure on the market interest rates. The corporates may increase their borrowings from outside the country as interest rates are low there, which may have a softening effect on the domestic interest rates. On balance, we would like to believe that the market interest rates may increase further.

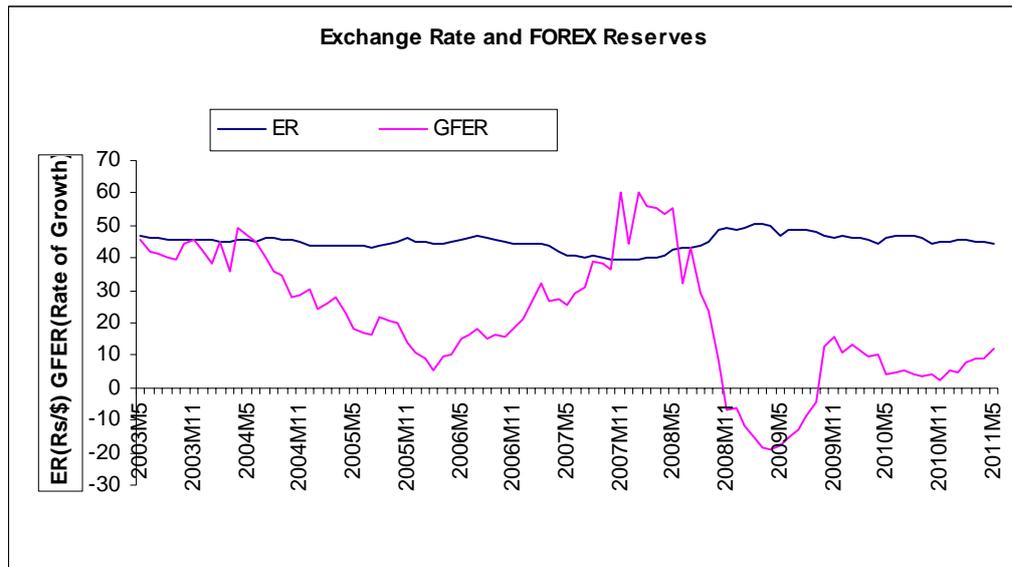
Exchange rate

Rupee depreciate marginally

The monthly average of rupee was 44.62 till May 20 as against 44.78 till April 13 and 45.18 till March 17, 2011. The continuous flow of FIIs into Indian stock market and the strong growth of Indian economy in recent months have assisted in strengthening the Indian rupee. The rupee hit a five month high on the 4th October 2010 at 44.24 rupees per dollar. Rupee appreciated 12.9 percent during the year 2009-10 as against a depreciation of 25.5 percent in the previous year. This appreciation was mainly due to economic recovery. Foreign institutional investors have started withdrawing from Indian stock exchanges due to the Eurozone crisis and the expected withdrawal of stimulus in USA. However, this appears to be a short run problem. Further, the expected widening of trade deficit caused by the rise in crude prices may put pressure on rupee. The rupee was 46.55 per dollar in August, 46.85 in July and 46.56 in June 2010. The rupee has depreciated to these levels with respect to the previous couple of months, though it appreciated in comparison with the June 2009 figure of 47.67, mainly due to the drying of flows to the Indian stock market due to the Euro zone crisis. The exchange rate was 45.47 in February and 45.34 in January 2011, 45.21 in December, 44.94 in November and 44.45 in October 2010.

Forecast:

In coming months, exchange rate is expected to be around Rs/\$45.07 , Rs/\$44.97 and Rs/\$44.68 for June, July and August 2011



Foreign Exchange Reserves

Foreign exchange reserves stood at US\$ 307.49 billion on May 13, 2011 as against US\$ 308.20 billion on April 8, US\$ 302.59 billion on March 4, US\$ 299.39 and billion on January 21, 2011. It went up progressively from US\$ 273.72 billion in May 28, 2010 to US\$ 297.99 billion on November 19 and US\$ 295.03 billion on December 24, 2010. This is a substantial progress from last year when reserves reached below 250 billion mark, though it is away from the peak of 314.61 billion of May 2008. The rise in reserves is mainly due to inflow of foreign investment into Indian market. The rise in stock market indices attracted huge FII inflows. The high interest rate differentials between India and the rest of the world, which is also likely to continue for some time, must have helped in this increase. However, due to the middle east crisis and the predicted higher growth rate for world economy, the high oil import prices could restrain the accumulation of reserves. The increasing outflow of Indian FDI to other countries is also restraining the accumulation. On balance, we forecast higher reserves for the next three months.

Forecast:

Forex reserves expected to be \$309.50 billions, \$310.43billions and \$ 311.53billions in June July and August 2011

Foreign Institutional Investment

The monthly foreign institutional investments (FIIs) in Indian market was a negative US\$ -651.93 million till May 20, 2011 as against US\$ 102.98 million till April 8 and a negative of US\$ -721.13 million for February 2011. This is due to the Eurozone crisis and the expected withdrawal of stimulus in USA economy. Whereas the FIIs were US\$ 710 million in December, US\$ 4784

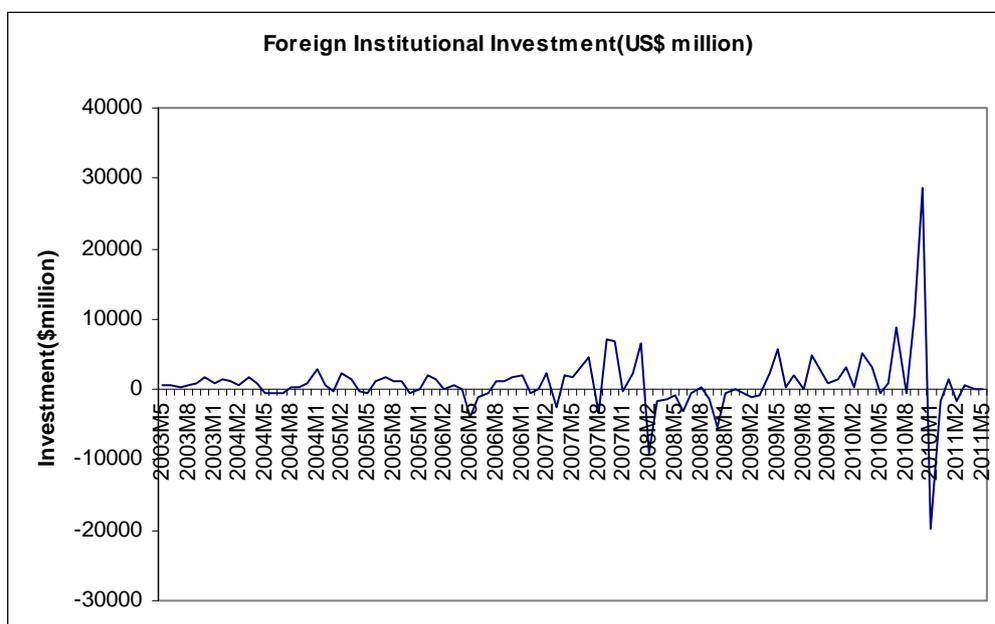
FIIs flows are negative

million in November, US\$ 5468 million in October, US\$ 4262.60 million in September, US\$ 3082.75 million in August, US\$ 5285.33 million in July and US\$2433.99 million in June 2010. These figures clearly show the foreign investors' confidence about India's long term growth story though in the last three months they are quite low. The expected medium term appreciation of rupee and the prospects of returns are making Indian economy attractive for FII inflows in medium to long term.

The FII flows was as low as US\$ -1504.87 million in May mainly due to Euro zone crisis, US \$2783.32 millions in April 2010, US \$5206 million in March and only US \$230 million in February 2010. For 2009-10, the cumulative FIIs were 29047 million as against -15017 million for 2008-09. The revival in major global economies along with the improvement in Indian share markets have helped in reversing the negative trend of foreign institutional investments of the crisis period of the economy. After registering a huge fall during the crisis, the 30 share index of Bombay Stock exchange Sensex went up above the high 20,000 mark though in last couple of months, the index is around 18000 due to the high oil prices. The high inflation indicating further rise in interest rates, expected falling rate of profit due to increase in input prices are also weighing down the Sensex. It is forecasted that the flows are likely to pick up momentum, in the next three months.

Forecast:

Inflows to pick up momentum in the next three months



Exports and Imports

The revival in the external demand following the recovery in industrialized nations and large base effect has resulted in this sustained positive growth in exports. The exports to USA, Asia and the newer markets of Africa have helped sustaining the high growth. The

Exports keeps momentum

export growth was at 34.4% in April, led by a 109 percent growth in engineering goods, maintaining the momentum from the previous months' growth of 43.9 percent in March and 49.8 percent in February 2011. The exports rose at a healthy 37.5 percent during April 2010-march 2011. It is expected that the exports would grow at an average of 28 percent in next three month. However, higher inflations at home may not be a good sign for export.

Imports grows at 14.1 percent

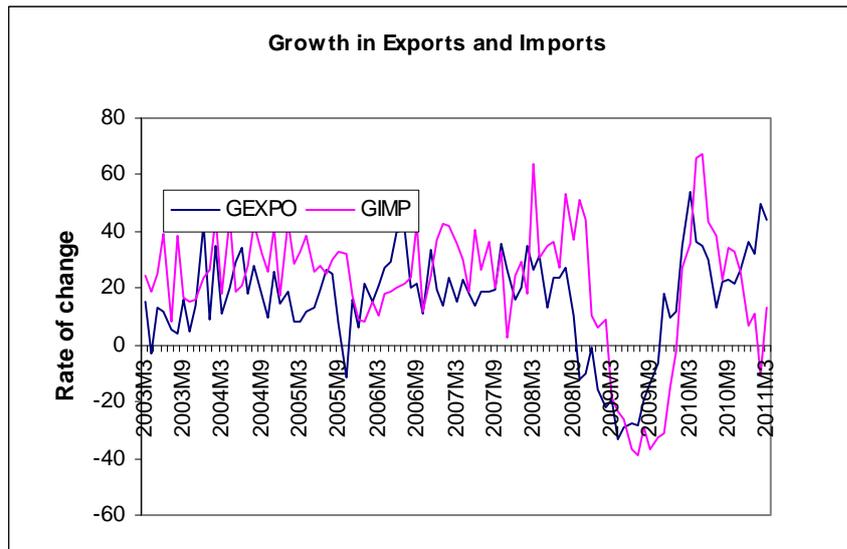
Imports grew by 14.1 percent in April as against a rise of 17.27 percent in March, 21.61 percent in February and 13.1 percent in January, 2011. It fell by 11.1 percent in December, and grew at 11.2 percent in November, 6.8 percent in October, 26.1 percent in September, and 32.6 percent in August, at 34.3 percent in July, at 23 percent in June and at 38.5 per cent in May 2010. In March 2011, non-oil imports grew at 21 percent, while oil imports rose by 8.2 percent over the corresponding period last year. Non-oil imports during April 2010 – March 2011 are 23.7 per cent higher than the non-oil imports in the same period last year while the figure for oil imports is 16.7 percent. The substantive rise in non-oil imports during last ten months shows the demand side is stabilizing at a higher level due to the rapid recovery process in the domestic economy.

Trade deficit is up

The trade deficit is up at 8.9 billion in April 2011. It was down to US\$ 5.61 billion in March 2011 against US\$ 9.37 billion a year ago. It was US\$ 8.1 billion in February and US\$ 7.9 billion in January 2011. The trade deficit for April - March, 2010-11 was US\$ 104.8 billion versus US\$ 109.6 billion, for the same period, a year ago. The deficit is a concern though it is increasing at a slower rate due to the lower growth of imports. The exports are forecasted to increase at a faster pace than the imports for the next three months bringing down the growth in deficits further. The Eurozone crisis and the expected withdrawal of stimulus in USA is a concern for our exports.

Forecast:

Exports growths and import growths are forecasted as average of 28.12% and 11.6% for the next three months.



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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