



सत्यमेव जयते

MONTHLY MONITOR

Prepared by

Basanta K Pradhan & Sangeeta Chakravarty

August

2010

Industrial growth cools down

Highlights

The annual growth of Index of Industrial Production for the month of June has come out at 7.1 percent versus 11.6 percent in May 2010, and is largely explained by the wearing down of the base effects. The IIP grew at 17.6 percent in April and at 13.5 percent in March 2010. The 7.1 per cent growth in IIP came after the eighth straight double-digit monthly expansion, driven largely by robust manufacturing output. The uptrend in industrial activity, though at a slower pace, continues. The recovery has also become more broad-based with 14 out of 17 industry groups recording positive growth during the year 2009-10.

WPI inflation falls marginally

Inflation rate stood at 9.97 percent, for the month of July 2010 as compared to 10.55 percent in June 2010. It was 10.16 percent in May and 9.59 percent in April 2010. The data for May 2010 was revised upwards to 11.14 percent. The rapid rise of IIP, the slow growth of agriculture and the low base effect in last few months explains this double digit inflation. The recent cooling down, the inflation of July is the slowest in last six months, is also due to the starting of the wearing down of the base effect as well as the dampening of the expectation of food price inflation.

Rupee appreciates marginally

The rupee was 46.55 per dollar in August, 46.85 in July and 46.56 in June 2010 as against 44.44 on April 30, 2010 which was 19 months high. 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 Eurozone crisis. It is forecasted to remain around the current level in the next three months.

FII flows are at high US\$ 3082 million

The foreign institutional investments (FII) in Indian market were around US\$ 3082.75 million in August 2010. The FII was 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 prospects. The expected medium long term appreciation of rupee is increasing the prospects of returns further. The FII flows was as low as

Development Planning Centre, Institute of Economic Growth, Delhi University Enclave, Delhi-110007, India. Phone: (00)-91-11-27667365, Fax: (00)-91-11-27667410

E-mail: basanta@iegindia.org / sangeeta@iegindia.org URL: www.iegindia.org

<p><i>Exports slowing down to 13.2 percent in July</i></p>	<p>US\$ -1504.87 million in May mainly due to Euro zone crisis.</p> <p>India's exports after growing at a very high pace in past few months is slowing down due to the slow recovery in USA and Europe. The wearing out of the base effects is also contributing to this slow down. Where as imports are growing due to a steep increase non-oil imports on the back of high domestic demand. The exports expanded at 13.2 percent and imports grew at 34.3 percent in dollar terms in July 2010.</p>
--	---

IEG FORECAST

Variables	Latest Information available	Forecast for next three months
Inflation rate (WPI)	9.97% in July 2010	9.93%, 8.86%, 8.65%.
Inflation rate (CPI)	11.25% in July 2010	12.54%, 11.37%, 11.52%
Growth rate of IIP	7.1% in June 2010	7.54 %, 8.21%, 6.52%
Growth rate of M3	15.23% on August 13,2010.	15.34 %, 15.40 %, 15.56 %
Re/\$ exchange rate	46.55 in August,2010	46.69, 46.64, 46.60
Forex reserves	(US\$ 283.88 billion on August, 2010)	\$286.27, \$289.65,\$290.99
FII inflows (Net)	US\$3082.75million in August, 2010	Inflows to be moderate
Growth rate of exports	13.2% for July 2010	15.04%,15.87%,12.09%
Growth rate of imports	34.3% for July 2010	33.82%,35.41%,38.12%

WPI inflation falls marginally

Inflation

Inflation rate stood at 9.97 percent, the slowest in last six months, for the month of July 2010 as compared to 10.55 percent in June 2010. It was 10.16 percent in May and 9.59 percent in April 2010. The data for May 2010 was revised upwards to 11.14 percent. The rapid rise of IIP, the slow growth of agriculture and the low base effect in last few months explains this double digit inflation.

The primary articles index with a weight of 22.02 percent was up 1.9 percent in July 2010 over the previous month while the index for fuel, power, light and lubricants with a weight 14.23 percent rose by 3.2 percent where as the index for major sector, the manufacturing products with a weight of 63.75 percent declined by 0.1 percent.

The recent decline in food and fuel prices indicates a marginal cooling down of inflation. Except for the East and the North-East, the rainfall has already been adequate and there is already a perceptible shift towards high value crops which may bring down the inflationary expectations in Food sector. On the other hand, the 27.4 percent growth of consumer durables along with the high GDP growth shows that the private demand is not slowing down. However, the withering of the base effect, the continuing monetary tightening of RBI though at a slower pace and the medium term rising trend of rupee will put a downward pressure on inflation. On balance, the inflation is likely to cool down in the next three months.

CPI decreases

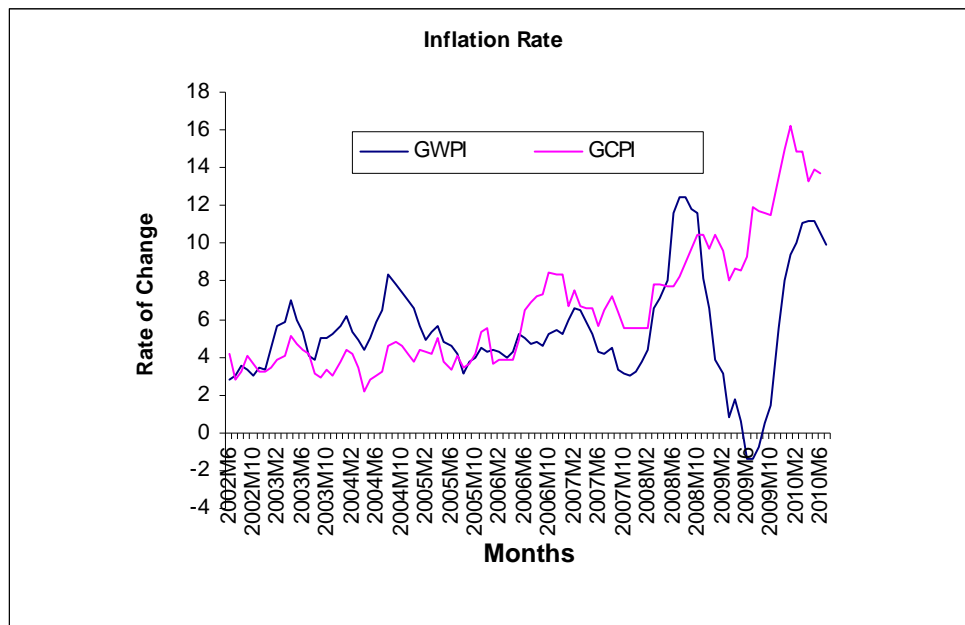
The annual growth in all India Consumer Price Index Number for Industrial Workers in the month of July 2010 came down to 11.25 percent from 13.73 percent in June 2010. It was 13.91 percent in May and 13.33 percent in April 2010. In March, 2010 it remained at 14.86 percent which was same as the growth in February, 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, the double digit growth of CPI will continue for the next three months.

Forecast:

The WPI inflation forecasts are 9.93%, 8.86%, and 8.65% for August, September and October , 2010, respectively. The CPI inflation forecasts are 12.54%, 11.37% and 11.52% for August, September and October 2010, respectively.

**Industrial growth
cools down**

**The slow IIP
growth at 7.1
percent**



Industrial Production

The annual growth of Index of Industrial Production for the month of June has come out at 7.1 percent versus 11.6 percent in May 2010, and is largely explained by the wearing down of the base effects. The IIP grew at 17.6 percent in April and at 13.5 percent in March 2010. The 7.1 per cent growth in IIP came after the eighth straight double-digit monthly expansion, driven largely by robust manufacturing output. The index recorded a growth of 17.6 per cent in December 2009, 16.7 per cent in January 2010 and 15.1 percent in February 2010.

The uptrend, though at a slower rate, in industrial activity continues. The recovery has also become more broad-based with 14 out of 17 industry groups recording positive growth during the year 2009-10. During June 2010, 13 groups showed positive growth out of 17 groups. The revival in demand supported by the low base for the year 2009 is able to deliver this continuous high growth. However the base effect is wearing out now pulling down the growth rate to normal levels. The global recovery is also expected to be weak. The IIP growth is likely to hover around this rate due to the base effect and the expected tightening of monetary policy by the RBI, even though the expected good monsoon may put a break on inflationary expectations. The pace of growth is seen to be tapering off as the low-base effect wears off and the impact of rate hikes and withdrawal of stimulus picks up.

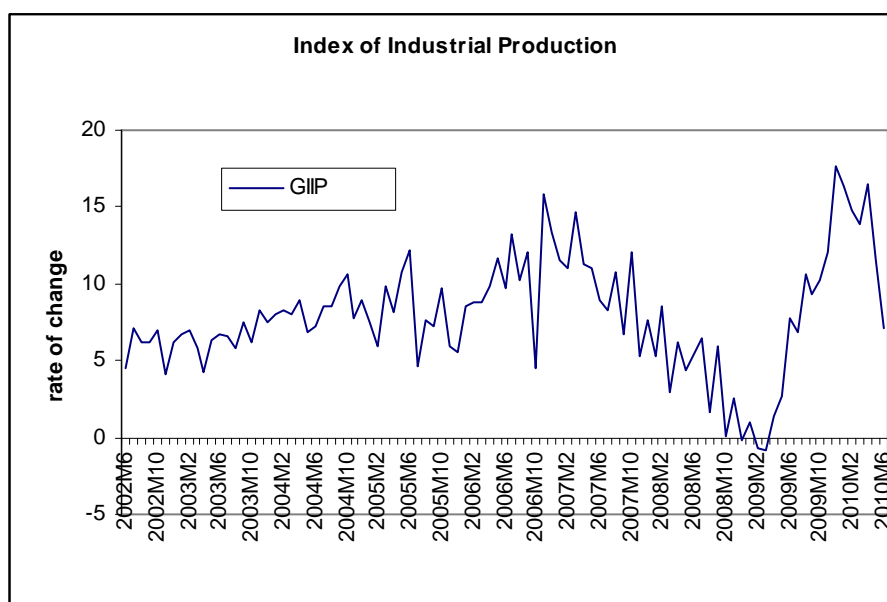
The Mining, Manufacturing and Electricity sectors for the month of June 2010 grew at 9.5 percent, 7.3 percent and 3.5 percent, respectively, as compared to the same month in the previous year. The mining sector may slow down in the in short run as environmental and tribal rights issues may take time to resolve. Even though the domestic demand remains strong, the

expected slowing down of the global demand may act as a constraint for the growth in Manufacturing sector.

The annual growth rates in Basic goods, in Capital goods and in Intermediate goods are 3.4 percent, 9.7 percent, and 8.7 percent in June 2010. The Consumer goods grew at 8.3 percent in June 2010 while the Consumer durables grew at 27.4 percent and Consumer non-durables at 1.3 percent. The 9.7 percent Capital goods growth is a good sign for sustaining the over all growth rate in the economy.

Forecast:

Based on the available information we forecast the IIP growth rate for the next three months to be 7.54%, 8.21% and 6.52% for July, August and September 2010.



Money and Credit

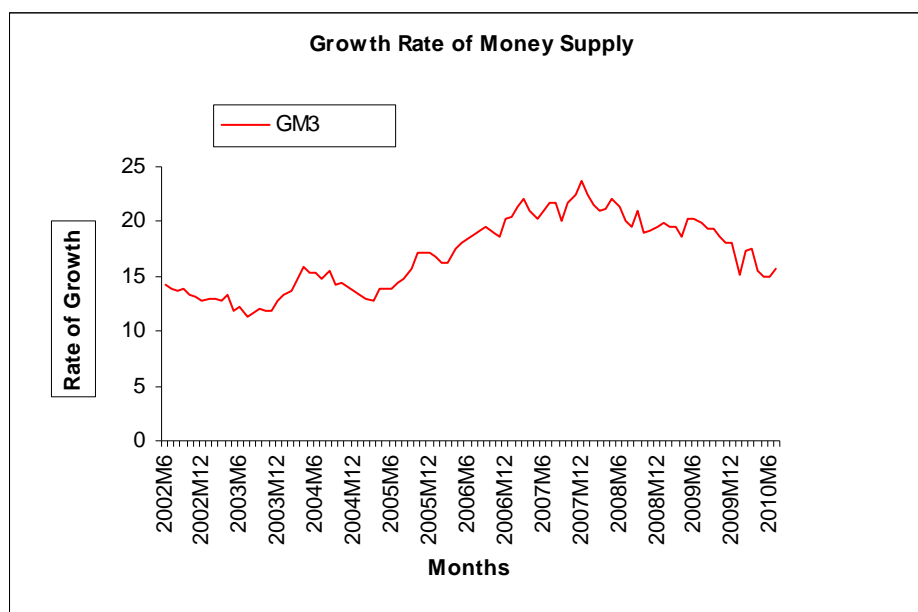
As on August 13, 2010, Money Supply grew at 15.23 percent. It grew at a faster rate of 15.66 percent in July as against 14.5 percent June 18 and 15.03 percent on May 21, 2010. Though the monetary tightening of RBI has reduced the liquidity in the system, the picking up of credit off take has helped the money supply to increase to an extent. The huge fees, the central government is going to receive from the 3 G auctions may slow down the borrowing program of the government this fiscal. The expansion in money supply is likely to be mainly contributed by credit to the commercial sector and increase in net foreign assets. The bankers are predicting that the credit off take is likely to pick up in the second half of this financial year. The money supply is forecasted to grow at about 15.5 percent for the next three months.

Forecast:

The forecast for the growth rate of money supply (M3) is 15.34 %,

Money supply at 15.23 percent

15.40% and 15.56 % for September, October and November 2010.



Interest rates

Interest rates rises

As the positive signs of the revival of the economy is sustaining itself, 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 pressure in the economy. The RBI has already raised its repo rate by 100 basic points since March 2010. The rise in prices, though has started cooling down, has already spilled over from supply to demand side. The prime lending rates are also seeing upward revision. In the medium term, high 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. In this scenario, the RBI needs to maintain a fine balance so as to put pressure on inflation without disturbing the growth path.

Though the inflation rates (WPI) has started coming down from the double digits, the inflationary expectations are continues to be high even though the growth in food prices are likely to decline. The growth momentum in the economy backed by domestic demand is putting pressure on prices. Thus the complexities of macro economic management are likely to increase as the global recovery is expected to slow down. On balance, we would like to believe that the policy rates may be revised upwards in small doses in medium run.

Exchange rate

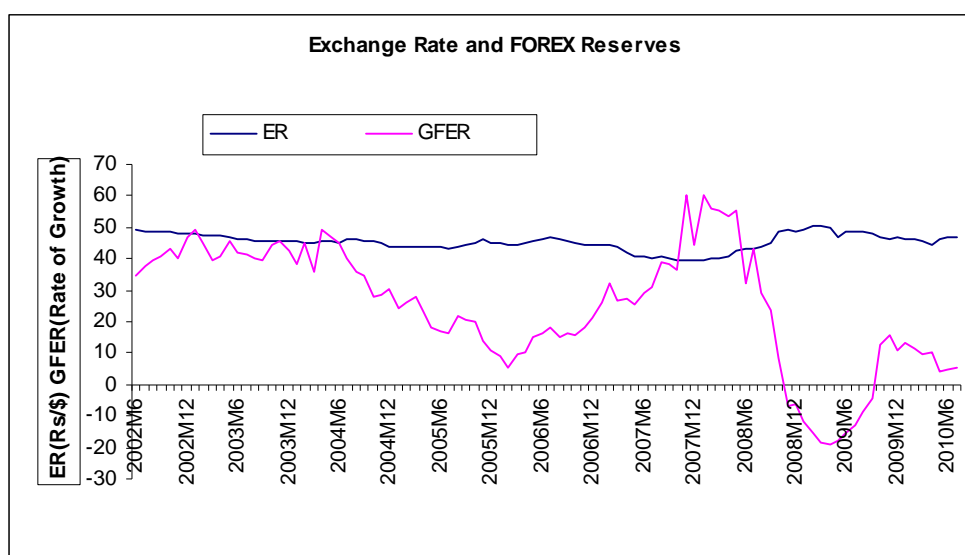
The continuous flow of FIIs into Indian stock market and the strong growth of Indian economy in recent months have assisted in strengthening the Indian rupee. The exchange rate was 44.44 on April 30, 2010 hitting a 19 month

Rupee appreciates marginally

high. 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 been returning to Indian stock exchanges due to the foreign investors' confidence about India's long term growth prospects. However, the expected widening of trade deficit 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 Eurozone crisis. It is forecasted to remain around the current level in the next three months. The RBI is likely to intervene to reduce the volatility in Rupee but it may let rupee appreciate in the long run.

Forecast:

In coming months, exchange rate is expected to be around Rs/\$46.69, Rs/\$46.64 and Rs/\$46.60 for September, October and November 2010.



Foreign Exchange Reserves

Foreign exchange reserves stood at US\$ 283.88 billion in August 31, 2010. It was US\$282.94 billion on July 23, US\$ 276.98 billion on 25TH June, US\$ 273.72 billion in May 28, US\$ 279.63 billion in April, US\$279.06 billion in March and US\$278.36 billion in February 2010. This is a progress from a few months back 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 high interest rate differentials between India and the rest of the world as well as the rising rupee, which is also likely to continue for sometime, must have helped in this increase. The rise in stock market indices also attracting FII inflows. However, the expected slowing down in global recovery, could

hamper inflow of foreign funds. Besides, if the world economy grows at the predicted rate, the high oil import prices could also restrain the accumulation of reserves. The likely outflow of Indian FDI to other countries could also restrain the accumulation.

Forecast:

Forex reserves expected to be \$286.27 billions, \$289.65 billions and \$290.99 billions in September, October and November 2010

Foreign Institutional Investment

The foreign institutional investments (FII) in Indian market were around US\$ 3082.75 million in August 2010. The FII was 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 prospects. The expected medium long term appreciation of rupee is increasing the prospects of returns further. 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.

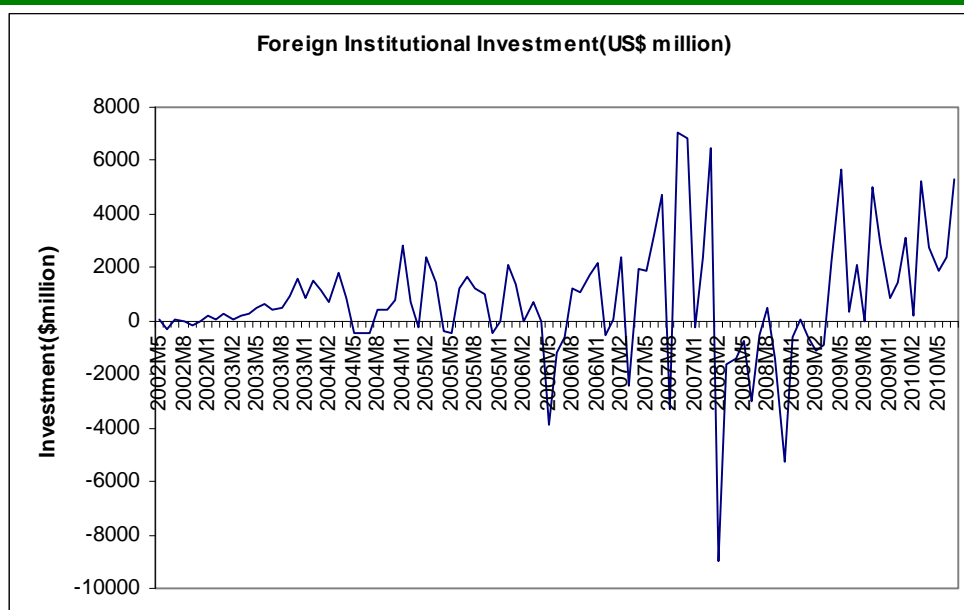
For 2009-10, the cumulative FIIs were 29047 million as against -15017 million for 2008-09. The revival in major global economies along with the improvement in Indian share markets have helped in reversing the negative trend of foreign institutional investments of the crisis period of the economy. After registering a huge fall during the crisis, the 30 share index of Bombay Stock exchange Sensex started recovering and is hovering around at a high 18,000 mark recently showing renewed confidence of Indian as well as foreign investors resulting in reversing of FIIs movements. However, the current global cues are not conducive which may put a break in the FII flows. On balance, it is forecasted that the growth in flows is likely to be positive for the next three months.

Forecast:

Growth in inflows are expected to be moderate in next three months

Foreign Exchange Reserves at healthy US\$ 283.88 billion

FII flows are at high US\$ 3082 million



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. However as the base effect is wearing down the export growth has slowed down in July. In July, 2010, India's exports rose at an annual 13.2 percent to US \$ 16.2 billion where as it grew at an annual 30.4 percent in June, at 35 percent in May and at 36.2 percent in April 2010. The demand has picked up for India's iron ore, oil and leather goods. However, the jump in exports growth can also be attributed to the statistical base effect. This is the seventh consecutive rise after 13 straight months of decline. India's exports increased in March 2010 at the fastest pace in six years at 54.1 percent in dollar terms. This is in spite of the Indian rupee strengthening for May, 2010. It is expected that the exports would grow at around 15 percent in the next three months. This low forecast, despite the recent stimulus majors by government to increase exports, is mainly due to the grim global scenario.

Imports rose at 34.3 percent to US \$ 29.8 billion in July, 2010 where as it grew at 23 percent in June and at 38.5 percent in May 2010. In July 2010, oil imports grew only at 4.4 percent over the corresponding period last year, while non-oil imports grew at 49.6 percent. Oil imports in June, 2010 grew at 26.5 percent, in May at 66.7 percent, and in April at 70.5 percent. Non-oil imports grew at 21.5 percent in June 2010, 32.3 percent in May 2010 and in April at 34.3 percent. The substantive rise in non-oil imports during last few months shows the demand side is picking up due to the fast recovery process in the economy.

The trade deficit widened to US\$12.9 billion in July, 2010 from US\$10.6 billion in June. The deficit was US\$11.3 billion in May and US\$10.4 billion in April 2010. The larger positive trend in imports has resulted in widening of trade deficit. The imports are forecasted to increase at more than twice the

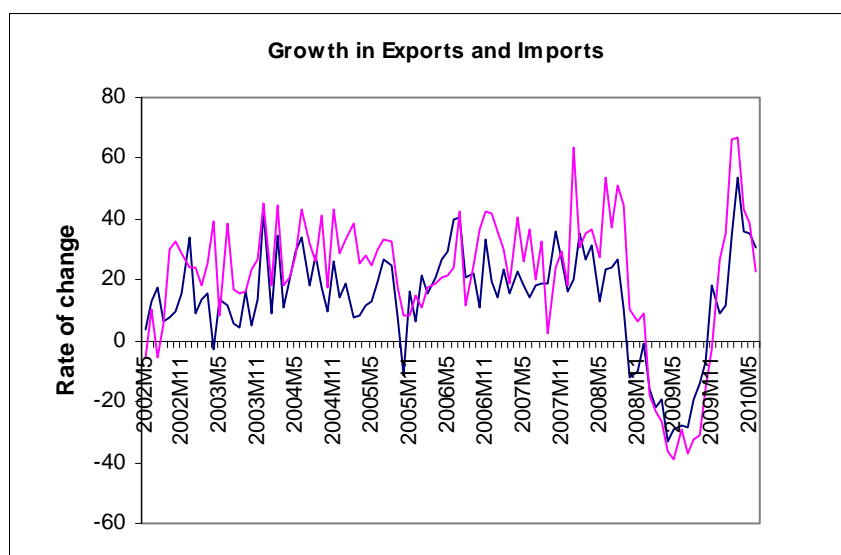
Exports slowing down to 13.2 percent in July

**Import stood at
34.3%**

rate of exports resulting in a higher deficit.

Forecast:

Exports growths are forecasted as 15.04%, 15.87 % and 12.09% for, August, September and October 2010 respectively. Imports are expected to increase by 33.82%, 35.41% and 38.12% for August, September and October 2010 respectively.



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

The views expressed in this document are authors alone and not to be attributed to the institute to which the authors belong.