MONTHLY MONITOR

Prepared by
Basanta K Pradhan & Sangeeta Chakravarty **January 2011**

Highlights

Industrial growth slows down

The annual growth of Index of Industrial Production for the month of has come out at a 18 month low of 2.7 percent in November versus 10.8 percent in October 2010, and is largely explained by a high fall of 6 percent in non-durable consumer goods. The capital goods increased at a whopping 63.0 percent in July 2010. The industrial activity is cooling down after many months of high growth.

Inflation moves upward

The year on year WPI inflation was 8.43 percent for December, 2010 as compared to 7.48 percent for November, 8.58 percent for October, 8.62 percent for September and 8.51 percent for August in the same year, based on the new series. 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 withering of the base effect and the continuing monetary tightening of RBI though at a slower pace are putting some downward pressure on inflation.

The annual growth in all India Consumer Price Index Number for Industrial Workers came went up to 9.47 percent in December from 8.33 percent in November, 2010.

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. However, the exchange rate depreciated marginally to 45.34 per dollar in January 2011 as continued inflation is putting a downward pressure. It is forecasted to depreciate for the next three months.

Quantum of FII flows increased marginally

Foreign exchange reserves stood at US$ 299.39 billion on January 21, 2011. It went up almost progressively from US$ 273.72 billion in May 28, 2010 to and US$ 295.03 billion on December 24, 2010. This is a substantial 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. These impressive figures clearly show the foreign investors' confidence about India's long term growth prospects.

Exports maintains its

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

growth momentum while imports growth is negative	**India's exports after growing at a very high pace in past few months and it grew at a healthy 36.4 percent in December 2010, mainly due to diversification of markets into Latin America and Africa and recovery in USA and EU. The imports contracted at 11.1 percent in dollar terms in December 2010 due to demand slowdown. The trade deficit in November 2010 was down to US$ 2.6 billion from 11.8 billion a year ago. The low deficit is due to the negative growth of imports.**

IEG FORECAST

Variables	Latest Information available	Forecast for next three months
Inflation rate (WPI)	8.43% in December 2010	8.72%, 8.15%, 7.83%
Inflation rate (CPI)	9.47% in December 2010	9.56%, 9.49%, 9.40%
Growth rate of IIP	2.7% in November 2010	7.38%, 7.79% , 6.94%
Growth rate of M3	16.6% in January 14, 2011	16.64 %,16.75%,16.82%
Re/$ exchange rate	. 45.34 in January 2011	45.53, 46.12, 46.38
Forex reserves	US$ 299.39 billion on 21st January, 2011	$297.63, $296.78, $299.28
FII inflows (Net)	US$ 1198.15 million in January, 2011	Inflows for the next three months to be in the lower side
Growth rate of exports	36.4% in December 2010	An average of 21.92% for next three months
Growth rate of imports	-11.1% in December 2010	An average of 9.47% for next three months

Inflation

WPI inflation goes up substantially

The year on year WPI inflation was 8.43 percent for December, 2010 as compared to 7.48 percent for November, 8.58 percent for October, 8.62 percent for September and 8.51 percent for August in the same year, based on the new series. 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 low base effect explains this high inflation for the last many months.

The primary articles index with a weight of 20.12 percent was up by rose by 3.5 percent 0.8 percent in November 2010 over the previous month while the index for fuel, power, light and lubricants with a weight 14.91 percent rose by 1.0 percent was up by 0.3 percent, and the index for the major sector, the manufacturing products with a weight of 64.97 percent rose by 0.4 percent increased also by 0.3 percent. The price for 'Food Articles' group rose by a high 3.7 percent, 'Non-Food Articles' by 2.3 percent and 'Minerals' by 3.4 percent over the last month. The prices of light diesel oil and furnace oil increased by 6 percents each, aviation turbine fuel, naphtha and bitumen by 5 percent each and petrol by 3 percent.

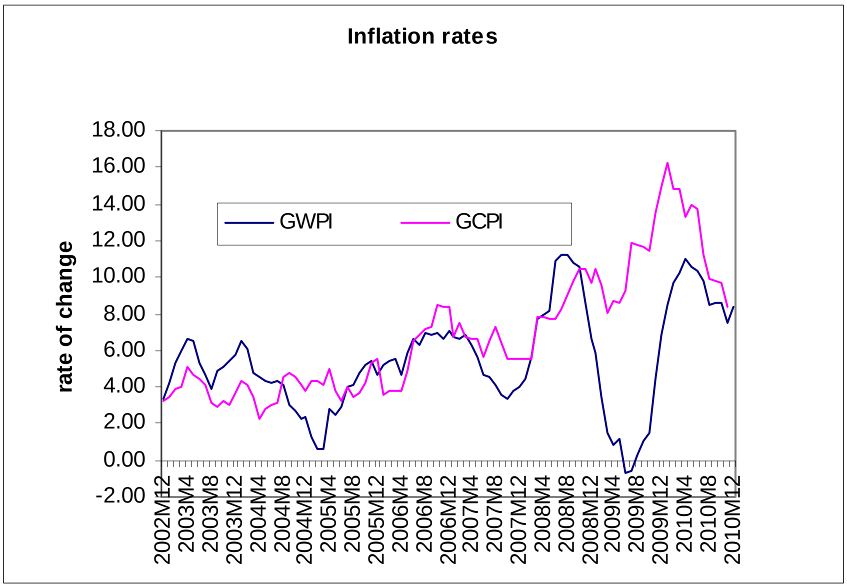
Though accelerated food price increase, the increase in input prices for manufacturing, the increasing trend of crude prices and the short-term falling trend of rupee are putting an upward pressure on inflation, the withering of the base effect, the continuing monetary tightening of RBI though at a slower pace and the other government measures are putting a downward pressure on inflation. On balance, the inflation is likely to be marginally high in the next month.

CPI nflation approaches double digits

The annual growth in all India Consumer Price Index Number for Industrial Workers came went up to 9.47 percent in December from 8.33 percent in November, 2010. The much sensitive food inflation went up steeply to 7.98 percent from 5.35 percent in the same period. 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.

Forecast:

The WPI inflation forecasts are8.72 %,8.15 %, and7.83 % for January , February and March 2011 respectively. The CPI inflation forecasts are 9.56%, 9.49% and 9.40% January ,February and March 2011 respectively.



Industrial Production

Industrial growth is sharply down

The annual growth of Index of Industrial Production for the month of has come out at a 18 month low of 2.7 percent in November versus 10.8 percent in October 2010, and is largely explained by a high fall of 6 percent in non-durable consumer goods. The IIP grew at 4.4 percent in September, 5.6 percent in August, 13.8 percent in July, 7.1 percent in June, at 11.6 percent in May, 17.6 percent in April and at 13.5 percent in March 2010. The 7.1 per cent growth in IIP in June came after the eighth straight double-digit monthly expansion, driven largely by robust manufacturing output. 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 cumulative growth for the period April-October 2010-11 is 10.3 percent over the same period in 2009. nine (9) out of the seventeen (17) The recovery has also become more broad-based with 14 out of 17 industry groups recording positive growth during the year 2009-10. During October 2010 also, out of 17 groups, 15 groups showed positive growth. 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 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 global recovery is also slow. The IIP growth is likely to hover around 7 percent in next three months due to the base effect and the tightening of monetary policy by the RBI.

The Mining, Manufacturing and Electricity sectors for the month of October 2010 grew at 6.0 percent, 2.3 percent and 4.6 percent, respectively, as compared to the same month in the previous year. Industry groups like ‘Transport Equipment and Parts’, ‘Leather and Leather & Fur Products’ and ‘Other Manufacturing Industries’ have increased at relatively high rates of 15.6

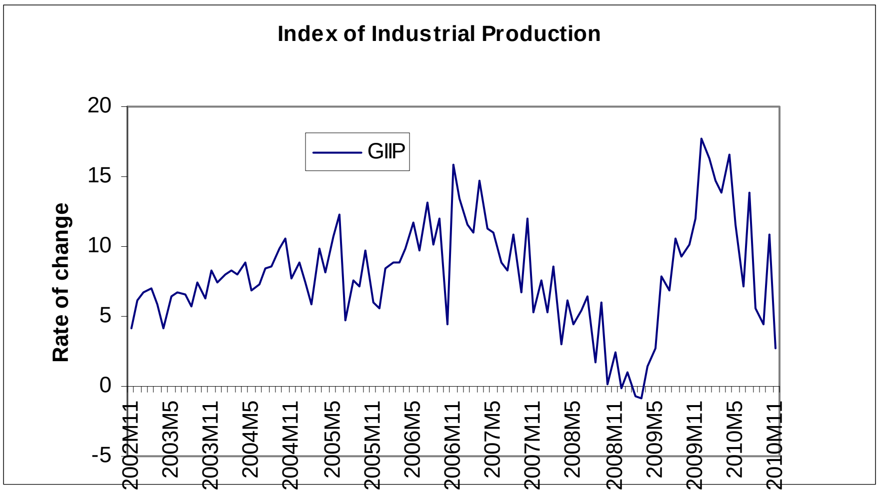
percent, 12.6 percent and 9.6 percent, respectively, and have helped the IIP to maintain its positive trend. The mining sector may slow down in the in short to medium run as environmental issues may take time to resolve. Similarly, land acquisition issues also affecting the industry sector as whole. 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.

Intermediate goods grow only at 2.4 percent

In November 2010, the annual growth rates in Basic goods and in Intermediate goods are 4.5 percent and 2.4 percent, where as Capital goods increased by 12.6 percent. The high Capital goods growth is a good sign for sustaining the over all growth rate in the economy especially when capacity constraint has started raising its head in the economy. The Consumer goods fell at 3.1 percent while the Consumer durables grew at 4.3 percent and Consumer non-durables decreased at a high 6 percent.

Forecast:

Based on the available information we forecast the IIP growth rate for the next three months to be 7.38%,7.79% and 6.94% for December2010, January and February2011



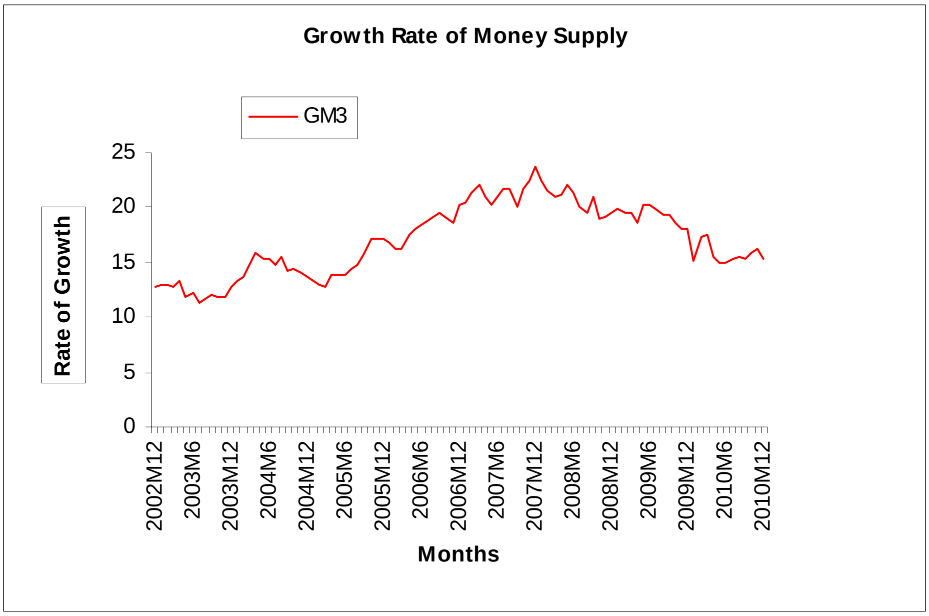
Money and Credit

Money supply up at 16.6 percent

As on January 14, 2011, Money supply grew at 16.6 percent as against 17.4 percent in the previous year. 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 18.2 percent and credit to commercial sector at 22.5 percent. Though the huge fees, the central government has received from the 3 G and broadband auctions have slowed down the borrowing program of the government this fiscal, the expected increase in social sector schemes has put pressure on the deficits. Though slowed down in last two months, the FIIs are pouring in money to India reaffirming their faith into its growth prospects. The government has increased the FII limits recently. The money supply is forecasted to grow at about 17 percent for the next three months.

Forecast:

The forecast for the growth rate of money supply (M3) is16.64 %,16.75 % and 16.82 % for February, March and April 2011, respectively.



Interest rates

Interest rates are in upward spiral

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 150 basic points since March 2010 to 6.25 percent. The reverse repo rate is now 5.25 percent. The rise in prices, though has started cooling down, has already spilled over from supply to demand side. The inflation rates (WPI) has started coming down from the double digits, however, the inflationary expectations continues to be high as the growth in food prices has risen. 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 interest rates. On balance, we would like to believe that the policy rates as well as the market interest rates may increase further.

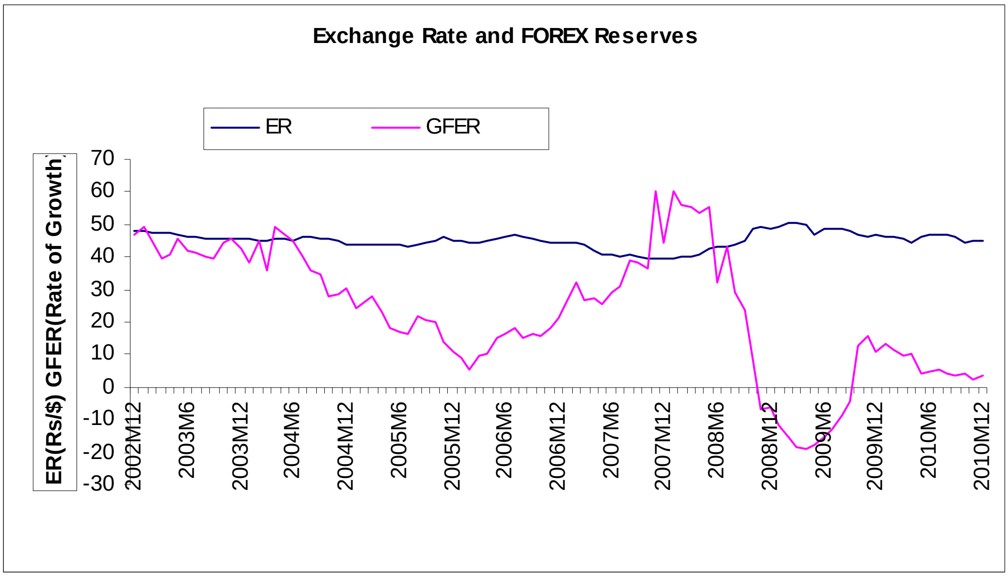
Exchange rate

Rupee depreciate 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. 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 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 Euro zone crisis. The exchange rate was 45.34 in January 2011, 45.21 in December, 44.94 in November and 44.45 in October 2010. It is forecasted to depreciate in the next three months due to inflationary concerns.

Forecast:

In coming months, exchange rate is expected to be around Rs/$45.53 , Rs/$46.12 and Rs/$46.38 for February, March and April 2011



Foreign Exchange Reserves

Foreign exchange reserves stood at US$ 299.39 billion on January 21, 2011. It went up progressively from US$ 273.72 billion in May 28, 2010 to US$ 297.99 billion on November19 and US$ 295.03 billion on December 24, 2010. This is a substantial 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 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 sometime, must have helped in this increase. However, if the world economy grows at the predicted rate, 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 marginally lower reserves for the next three months.

Foreign Exchange Reserves at healthy US$ 299.39 billion

Forecast:

Forex reserves expected to be $297.63 billions, $296.78billions and $299.28 billions in February, March and April 2011.

Foreign Institutional Investment

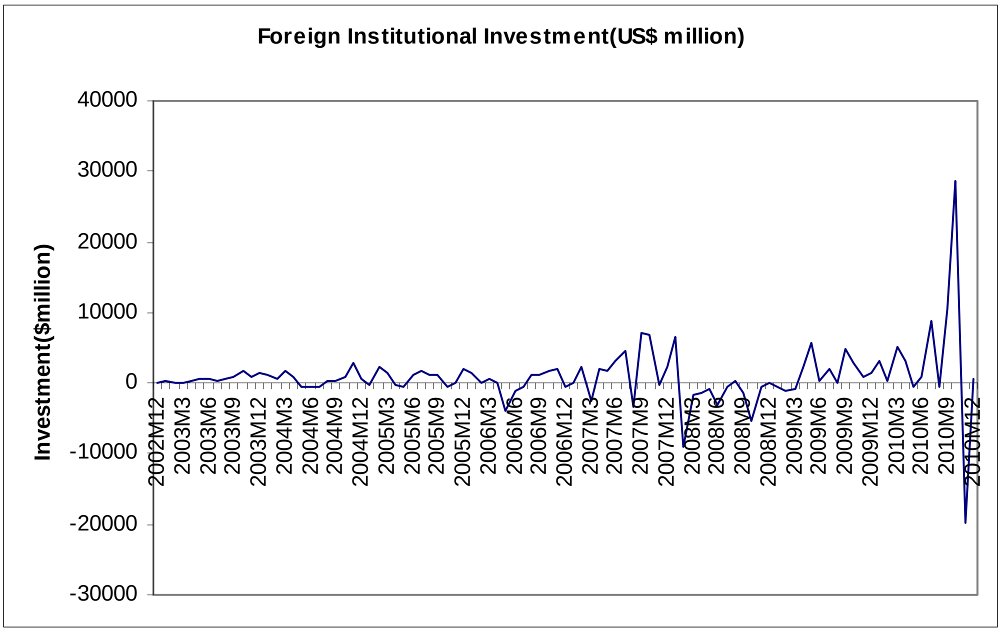
The foreign institutional investments (FIIs) in Indian market were only US$ 1198.15 million in December 2010. Where as the FIIs were US$ 710 million in December, US$ 4784 million in November, US$ 5468 million in October, US$ 4262.60 million in September, US$ 3082.75 million in August, US$ 5285.33 million 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 two 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.

FII flows are at low US$ 1198.15 million

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 few weeks the index is around 18000 due to the selling pressure exerted by the FIIs. 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 be on the lower side like the last two months, for the next three months.

Forecast:

Inflows for the next three months to be in the lower side in comparison to the last few months.



Exports and Imports

Exports rises at a high 36.4 percent

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 the newer markets of Latin America and Africa have helped sustaining the growth. The engineering sector posted remarkable growth. The export growth was at 36.4 percent in December at US$ 22.5 billion where as it was 26.5 percent in November at US$ 18.9 billion. It grew at an annual 21.3 percent in October, 23.2 percent in September, 22.5 percent in August, 13.2 percent in July, 30.4 percent in June, 35 percent in May and 36.2 percent in April 2010. India's exports increased in March 2010 at the fastest pace in six years at 54.1 percent. It is expected that the exports would grow at an average of 22 percent in next three month. Higher inflations at home may not be a good sign for export growth but the encouraging scenario in USA is a positive sign.

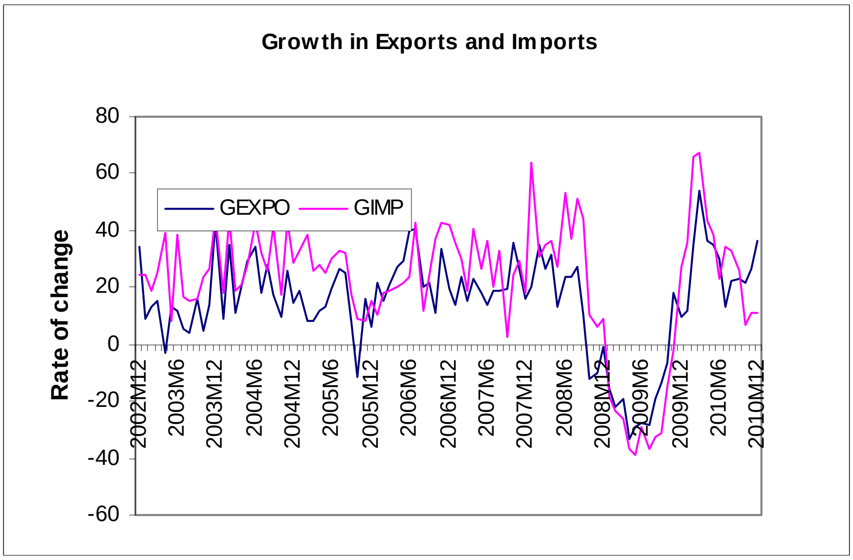
Imports growth is negative at -11.1 percent

Imports fell by 11.1 percent, mainly due to sharp fall in oil imports, in December, 2010 at US$ 25.1 billion as against a rise of 11.2 percent in November, 2010 at US$ 27.8 billion. It grew at a low 6.8 percent in October, 26.1 percent in September, 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. This low growth in November is mainly due to base effects. In December 2010, oil imports fell by 16 percent over the corresponding period last year, while non-oil imports grew at 9 percent. Non-oil imports during the April-December 2010 are 19.58 per cent higher than the level of such imports in the same period last year. The substantive rise in non-oil imports during last seven months shows the demand side is stabilizing at a higher level due to the rapid recovery process in the domestic economy.

The trade deficit in November 2010 was down to US$ 2.6 billion from 11.8 billion a year ago. The low deficit is due to the negative growth of imports. The deficit was US$ 8.9 billion in November, US$ 9.7 billion in October, US$ 9.12 billion in September, US$13.06 billion in August, US$12.9 billion in July, US$10.6 billion in June, US$11.3 billion in May and US$10.4 billion in April 2010. The exports are forecasted to increase at a faster pace than the imports.

Forecast:

We expect Exports and Imports growth to be around 21.92% and 9.47% 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**

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