MONTHLY MONITOR

Prepared by
Basanta K Pradhan & Sangeeta Chakravarty **July 2009**

	Highlights
Industrial sector showed spectacular growth **Sustained recovery depends on monetary policy response**	Industrial sector showed remarkable recovery signs. For June 2009, IIP growth stood at a spectacular 7.8 percent. This is contributed by sharp rise in the growth of capital goods, basic goods and consumer durable goods. Previous fiscal stimulus packages seem to start showing up on the industrial demand since last two months. But the sustenance of this would also depend on an accommodative monetary policy.
Inflation rate continues to be negative **Inflationary expectations building up following monsoon worries and high fiscal deficit**	Inflation rate continues to be negative. At the commodity group level, the prices of fuel group, iron & steel and edible oils have fallen. But the prices of sugar group and primary articles continue to increase (inflation in sugar group is at whooping 33.7 percent) and expected to increase even further. The grim monsoon situation and the expansionary fiscal policy have already led to rise in inflationary expectations for the coming months. Besides, further rise in the world oil prices would also be pushing prices in the coming months.
Money supply growth continues to be around 20 percent **Interest rates almost unmoved**	Money supply continues to grow around 19.8 percent. Sharp rise in the growth of bank credit to government sector has contributed to this high growth. But the growths in credit to commercial sector and net foreign exchange assets, which are the other contributors to money supply growth, have dropped by 15.1 percent and 2.2 percent as on July 24 2009 respectively. Following Budget, we don't expect fall in the money supply growth in the coming months. On the interest rate front, as fiscal deficit is expected to go up further in the current fiscal year, there would be an upward pressure on the rates in the medium term.
Both exports and imports continues to decline sharply **Trade deficit narrowing**	Deceleration in trade sector continues. Both exports and imports growth decelerated to -27.7 percent and -29.3 percent in June 2009. As the global economic outlook showing signs of recovery, we expect the fall in growth of exports to slow down in next three months. In terms of imports, oil imports would rise following increase in the world prices. But the demand for intermediate imports largely depends on the stimulus packages including the

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**

	planned astronomical increase in government expenditure.
Forex reserves increase to US$ 267.7 billions **Positive FII flows in May**	Foreign exchange reserves continue to rise. Currently it is at US$ 267.7 billions. Increase in foreign investments and reduction in trade deficit seems to help forex accumulation. The FIIs are also net buyers. Latest data show that in April 2009, FIIs invested nearlyUS$343 millions.
Exchange rate appreciates marginally	But this trend in forex reserves has shown some impact on exchange rate, which has appreciated marginally to 48.4 against US dollar. The future movement of exchange rate would depend on the behavior of foreign investment as well as world oil prices.

IEG forecasts

Variables	Latest Information available	Forecast for next Three months
Inflation rate (WPI)	-1.2 % as on 31st July, 2009	-1.3%, -0.9% and -0.45%
Inflation rate (CPI)	9.3 % in June 2009	8.12%, 7.67% and 7.25%
Growth rate of IIP	7.8 % in June 2009	5.9%, 7.5%, 7.4%
Growth rate of M3	19.8 % in July 2009.	19.61, 19.45, 19.3 percents
Prime lending rate	11-12 % as on 17th July 2009.	Expected to decline marginally below 11%
Re/$ exchange rate	48.38 on 24h July 2009	Depreciate to 48.98 by October 2009
Forex reserves	US $267.7 billion as on 24th July 2009.	$270.74, $281.32, $284.72 billion for next three months
FII inflows (Net)	US$ 343 millions in June 2009	FIIs to be Positive
Growth rate of exports	-27.7 as on June 2009	Exports are expected to decline by 26.5% for July
Growth rate of imports	-29.3% as on June 2009	Imports are also expected to decline by 23.11% for July

RBI First Quarter Review 2009

Reserve Bank of India in its first quarter review for the fiscal year 2009-10 have emphasized on price stability. The policies as indicated by the central bank would maintain a fine balance between being accommodative which implies providing adequate liquidity as well as containing inflation. Besides, it will be financing the government credit needs through open market operations, and other liquidity adjustment measures so as not to crowd out the private demand for funds. Thus it focuses on three broader aspects:

- To manage liquidity so as to meet the credit demand of the government without hampering flow of credit to the private sector at viable rates.
- To respond to price tends quickly and effectively through policy adjustments.
- To provide a monetary policies that targets interest rate regime consistent with price stability and financial stability supportive of growth.

The central bank have made no changes in its policy rates like bank rates, repo rates and reverse repo rates, as well as the ratio of reserve requirements of the banks. However, the RBI will be forced to review the rates once the inflation rate turns around in next few months due to monsoon impact as well as the build up of inflationary expectations.

Inflation

Inflation shows a short term downward trend

Inflation rate continues to be negative; for the month of July inflation rate (WPI) stood at -1.2 percent. The increase in Wholesale Price Index as compared to previous month was largely due to upward movement of the administered price of fuels that became effective from 2nd July 2009, the higher prices of food articles and some manufactured products. The rate of price rise in essential commodities was still ruling at 10.85 percent. The reason for year-on-year negative WPI is mainly due to the base effect rather than sharp contraction in demand.

Base effect has played an important role in WPI reduction

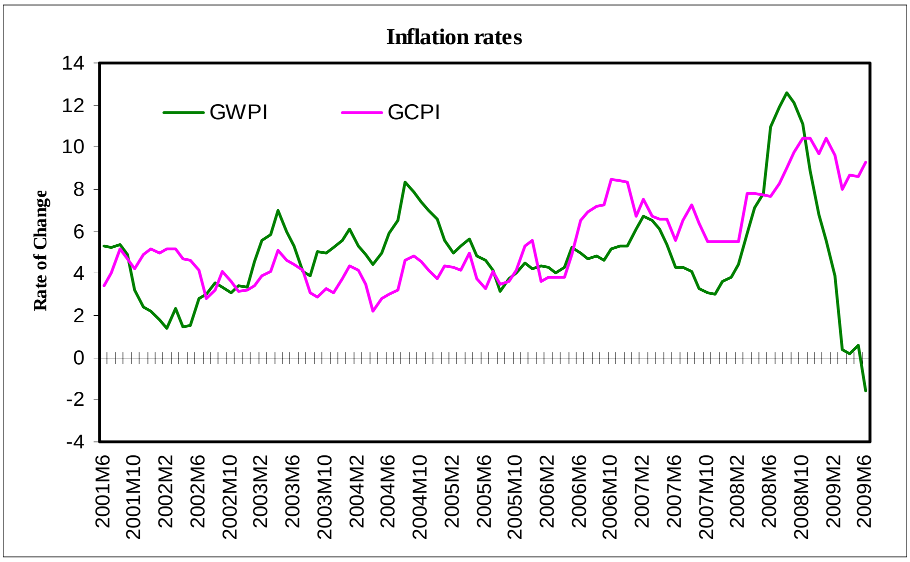
Inflation rate measured through WPI though was negative for past few months consumer price index was still very high and positive at 9.3 percent for the month of June. This implies that the real purchasing power of the consumer was still being adversely affected by high CPI.

CPI was still very high and growing at the rate of 9.3 percent for June

It is expected that the inflation would continue to be negative in coming months. However, the monsoon deficit and insufficient rainwater in most of the parts of the country, increase in Minimum Support Prices of some of the crops along with the ongoing loose monetary policy are likely to reverse this declining trend leading to an increase in inflation in foreseeable future. The sign of revival of the major economies will also put an upward pressure on the commodity prices. The net effects would depend on the inter play of the aforementioned factors.

Forecast:

The WPI inflation forecast for the next three months to be -1.3% for August, -0.9% for September and -0.4%for October 2009 respectively. Similarly, CPI was forecasted to grow at 8.12% for July, 7.67% for August and 7.25% for September 2009.



IIP recorded highest growth in past 13 months

Mining industries were largest contributors

Capital and basic goods performed extremely well

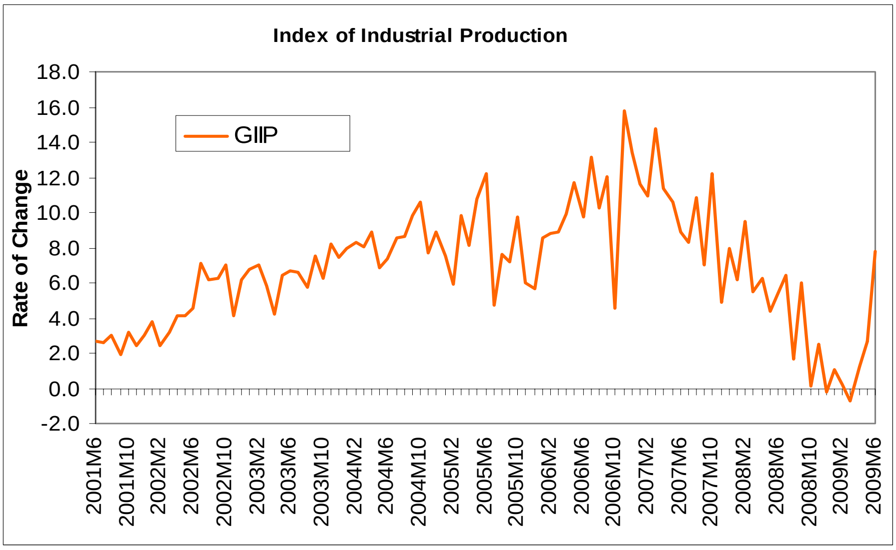
Money supply growth was slower as compared to previous month

Industrial Production

The Index for Industrial Production (IIP) has shown an impressive growth of 7.8 percent. This figure was higher than even the last year's growth of 5.4 percent and highest since the March 2008. This is definitely a pointer towards the revival of industrial growth. However, the poor monsoon may prove to be a dampener. The highest contributor to this spectacular growth was mining industries. The electricity and the manufacturing sectors also made positive contributions. Looking at the used based sectoral break-up, the largest contributors are capital goods industries and basic goods. Among consumer goods, consumer durables recorded maximum growth.

Forecast:

Based on the available information we forecast the IIP growth rate for the next three months August, September and October for 2009 are 5.9%, 7.5% and7.4% respectively.



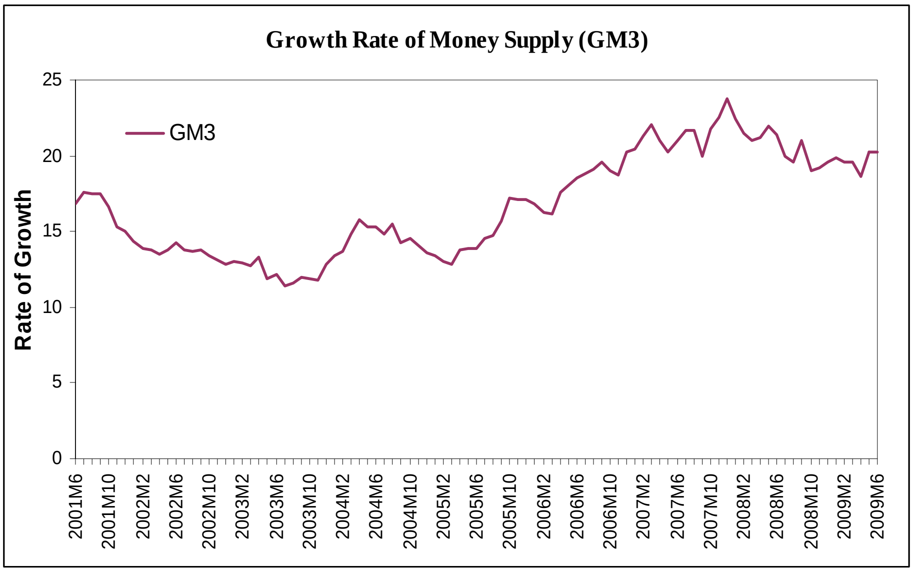
Money and Credit

Money supply measured by M3 grew but at a marginally slower rate. In the month of July the growth rate of money supply was 19.8 percent. This is a marginal fall from the previous figure of 20.2 percent in June 2009 was largely contributed by government credit programs. The government borrowing is likely to expand due to substantial fiscal expansion proposed under budget 2009-10. It is also expected to result in a high growth of money supply. Also the central bank monetary policies of maintaining adequate liquidity is certainly going to add to money supply owing to economic recoveries and increased fiscal expansion.

Planned large government expenditures are going to add to an increased money supply

Forecast:

We forecast the growth rate of money supply (M3) to remain at 19.61 for August, 19.45 for September and 19.3 percent for October2009



Interest rates

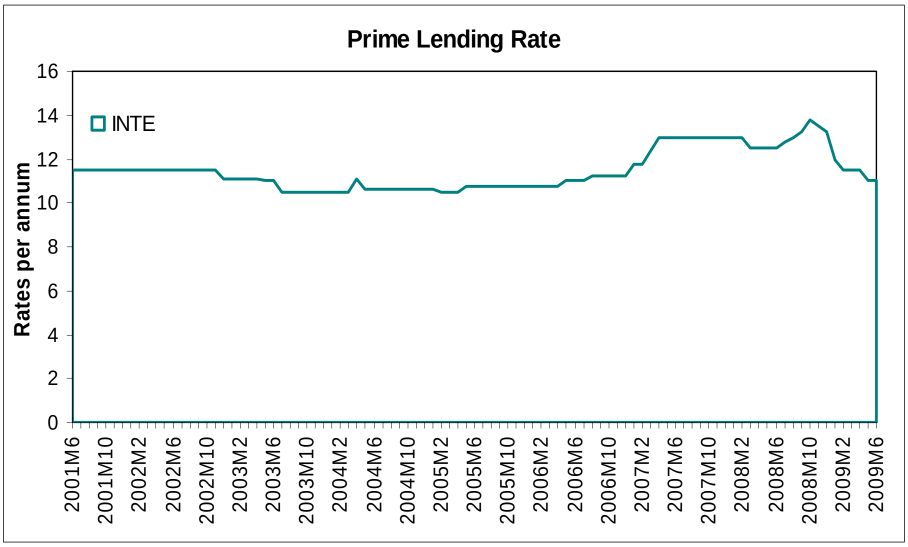
Due to weak transmission effect of changes in policy rates the market interest rates were relatively less responsive

The decline in the policy rates and past deflationary expectations has put downward pressure on the lending rates for quite some time. As the transmission of reduction in the policy interest rates on prime lending rates appears to be very weak, market rates have not seen much change as was expected. Currently the prime lending rates of five major banks is in the range of 11 to 12 percent. With negative inflation rates (WPI), there are pressures on the central bank to further cut the policy rates. However, there is not much scope for further reduction in rates for two reasons. First, negative inflationary situation is expected to be short-lived and inflationary expectation is already building-up. Secondly, monsoon deficit will put pressure on food prices.

Negative inflationary situation is expected to be short-lived there would become pressure on interest rates to decline in future

Forecast:

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



Exchange rate

Exchange rate appreciated marginally

FIIs inflow into India led to appreciation

The Rupee/US dollar exchange rate has appreciated very marginally from 48.7 in June to 48.4 Rs/US $ as on 24th July 2009. This marginal appreciation was mainly due to decline in the trade deficit and positive inflow of foreign capital (both FII and FDI) into India. Going forward, the movement exchange rate could largely depend on flow of foreign investments and the world oil prices. The high international prices of oil could lead to a depreciation of exchange rate to some extent in the coming months.

Forecast:

In coming months, exchange rate will depreciate to Rs48.98 per Us dollar by the month of October 2009.

Foreign Exchange Reserves

Foreign exchange reserves were US $ 267.71 billions for July 2009

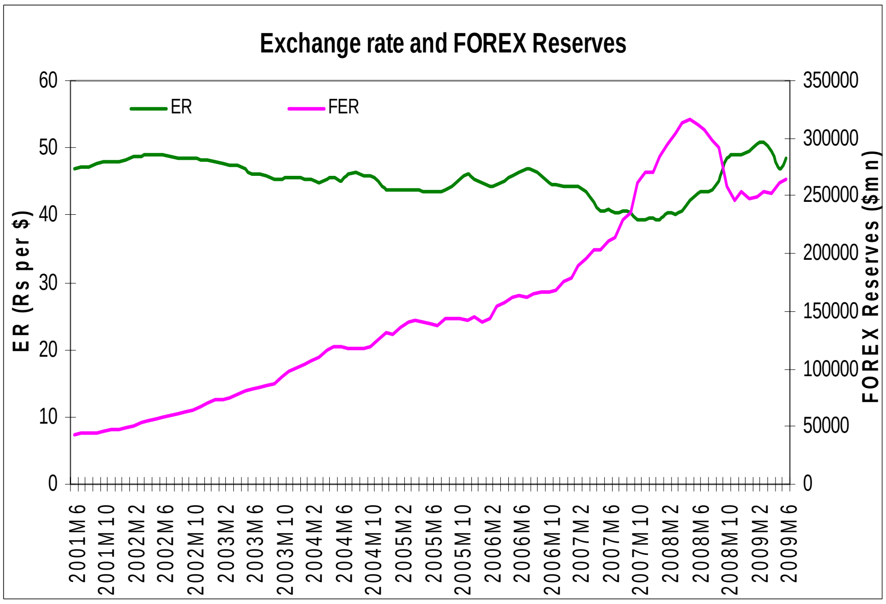
The foreign exchange reserves continue to get accumulated. In the month of July 2009 the reserves stood at US $ 267.71 billions. The monthly statistics shows an increase in foreign exchange reserve by 1.5 percent over the month of June 2009. This rise in reserves is mainly due to inflow of foreign investment into Indian market. Besides, high interest rate differentials between India and the rest of the world must have helped in this increase. As the world economy is looking up, the interest of foreign investors is likely to increase in the Indian market. However, the high government deficit, which is to continue for some more time, could hamper inflow of foreign funds. Besides, the high oil import bill could also restrain the accumulation of reserves.

Year on year basis there is substantial fall in foreign exchange reserves

However, as compared to July 2008 that is year on year basis there is substantial fall in foreign exchange reserves in July 2009 representing a global gloomy business situation that has adversely affected the foreign trade of the country and foreign investment inflows in India thus leading to depletion in forex reserves. Also due to same international trade situation the large fluctuations in currency rate has also added to depreciation in reserves.

Forecast:

Forex reserves expected to be $270.74 billion for August, $281.32 billion for Sept and $284.72 billion for October



Foreign Institutional Investment

The foreign institutional investments in Indian market were around US $343 millions in June 2009 alone. The revival in major global economies along with the improvement in Indian share markets have helped in arresting the negative trend of foreign institutional investments in the economy since last two months. After registering a huge fall, the Sensex started recovering and is now steady around 15000 points showing renewed confidence of Indian as well as foreign investors resulting in reversing of FIIs movements. BSE sensitive index had fallen to 8762.8 points in March 2009.

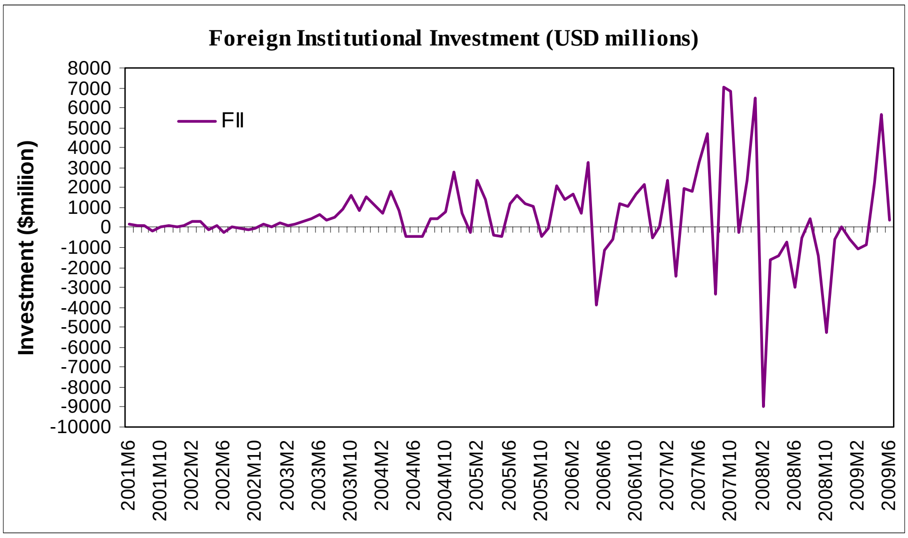
FII inflows turned positive

Global cues helping share markets to improve

The positive flows indicate that the global perception on the Indian economy seems to have turned positive. But the continuation of this trend largely depends on the domestic economic policies. If the planned government expenditure stimulates a macroeconomic recovery, which is too early to judge, then we might see strong inflows. On the other hand, the resultant deficit may prove to be a drag on the flows.

Forecast:

Foreign institutional investments are expected to increase in coming months.



Exports and Imports

Exports and Imports are still falling

India's export fell for the ninth month consecutively due to slowdown in global economy. In the month of June 2009 the exports registered a decline of 27.7 percent. The sluggishness in the in the external demand following recessionary trends in industrialized nations and large base effect must have resulted in this sustained negative growth in exports. As the global economic outlook is improving, we expect exports to decline at a slower rate in the next three months. The forthcoming five-year Foreign Trade Policy of the government, planned to be unveiled by the end of August, may energize exports in the labor intensive export sectors.

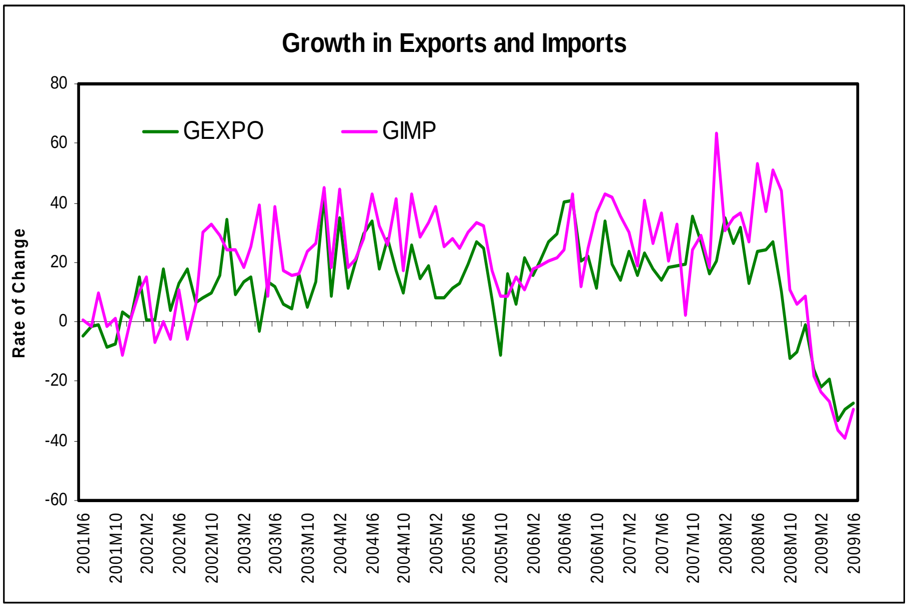
As world oil prices have gone up, the import bill is likely to get inflated

Imports also continued to decline for sixth consecutive months. Imports declined by 29.3 percent, at a steeper rate than exports reducing the trade deficit, reflecting the slowdown in domestic consumption and decrease in oil imports bill. The oil imports bill reduced by a whopping 51 percent.

As oil prices have gone up above US$ 70, in the world market, oil import bill is likely to get inflated substantially in short to medium term. But the non-oil imports largely depend on how the stimulus packages are playing out as well as on international commodity prices. The larger negative trend in imports has resulted in narrowing of trade deficit and the deficit is predicted to decline further.

Forecast:

Exports are forecasted to grow at a rate around -26.5 percent for July month and growth rate of imports is also expected to be around -23.11 percent for the month of July.



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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