MONTHLY MONITOR

Prepared by
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Highlights

Industrial growth picks up

The annual growth of Index of Industrial Production for the month of June has come out at 8.8 percent versus a cumulative growth for the first quarter of 2011-12 stands at 6.8 percent over the corresponding periods of the previous year. The reasonably high growth in June is largely explained by a high rise of 37.7 percent in the growth of capital goods. Though the industrial activity is showing the signs of pick up again, the inflationary concern and the global uncertainties remain.

WPI inflation falls marginally

The year on year WPI inflation was 9.22 percent in July, lower than the 9.44 percent for June 2011, and the marginal slowdown is largely explained by the high base effect. In July 2010, the inflation was 9.98 percent against 10.23 percent in March, the same year. Since August 2010 when the new series was introduced, the inflation was almost always higher than 8 percent. 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. 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

The annual growth in all India Consumer Price Index Number for Industrial Workers marginally came down to 8.62 percent in June from 8.72 percent in May 2011. This is due to the decline in the much sensitive food Inflation to 6.91 percent from 7.61 percent in the same period. Even though the CPI is high for June 2011, it is a steep climb down from the 13.73 percent in June 2010.

Depreciating Rupee

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 44.79 till August 24, 2011. However, very recently, it is touching 46 rupees mainly due to the withdrawal of FIIs.

Exchange Reserves up

Foreign exchange reserves went up almost progressively from US$ 273.72 billion on May 28, 2010 to US$ 317.23 billion on August 5, 2011. This is a substantial progress from not long ago when reserves reached below the 250 billion mark. It also surpassed the peak of

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	314.61 billion of May 2008. These impressive figures clearly show the foreign investors' confidence about India's long term growth prospects.
Exceptionally high exports growth while trade deficit is up	The export growth was at a stunning 81.8 percent in July as against a very high growth of 46.5 percent in June 2011. The exports rose at a healthy 36.2 percent during April -June 2011. Imports grew by a huge 51.5 percent in July as against a rise of 42.5 percent in June, 2011. Non-oil imports during April - June 2011 are 44.7 per cent higher than the non-oil imports in the same period last year while the figure for oil imports is 18.1 percent. The substantive rise in non-oil imports during last one year shows the demand side is stabilizing at a higher level due to the rapid recovery process in the domestic economy. The trade deficit is up at 11.1 billion US dollar in July from 7. 7 billion in June 2011. It was US$ 5.9 billion in June 2011. The trade deficit for April - June, 2011 was US$ 31.6 billion versus US$ 27.0 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.

IEG FORECAST

Variables	Latest Information available	Forecast for next three months
Inflation rate (WPI)	9.22% in July 2011	9.08%, 8.96%, 8.79%
Inflation rate (CPI)	8.62% in June 2011	8.69%, 8.71%, 8.59%
Growth rate of IIP	8.8% in June 2011	8.92%, 7.42% , 6.58%
Growth rate of M3	16.4% on July 29, 2011	16.54 %,16.42%,16.49%
Re/$ exchange rate	. 44.79 monthly average till August 24, 2011	45.24, 45.36, 45.47
Forex reserves	US$ 317.23 billion on August 5, 2011	$317.85, $318.26, $319.05
FII inflows (Net)	US$ -1790.59 million for the month till August 24, 2011	Inflows are expected to pick up in the next three months
Growth rate of exports	81.8% in July 2011	49.52%, 47.53%, 36.28%
Growth rate of imports	51.5% in July 2011	37.20%, 34.41%, 25.21%

Inflation

WPI inflation marginally down

The year on year WPI inflation was 9.22 percent in July, lower than the 9.44 percent for June 2011, and the marginal slowdown is largely explained by the high base effect. In July 2010, the inflation was 9.98 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 July 2011, the primary articles index with a weight of 20.12 percent rose by 0.2 percent while the index for fuel, power, light and lubricants with a weight 14.91 percent was up by 2.5 percent, and the index for the principal sector, the manufacturing products with a weight of 64.97 percent was up by 0.3 percent over the previous month.

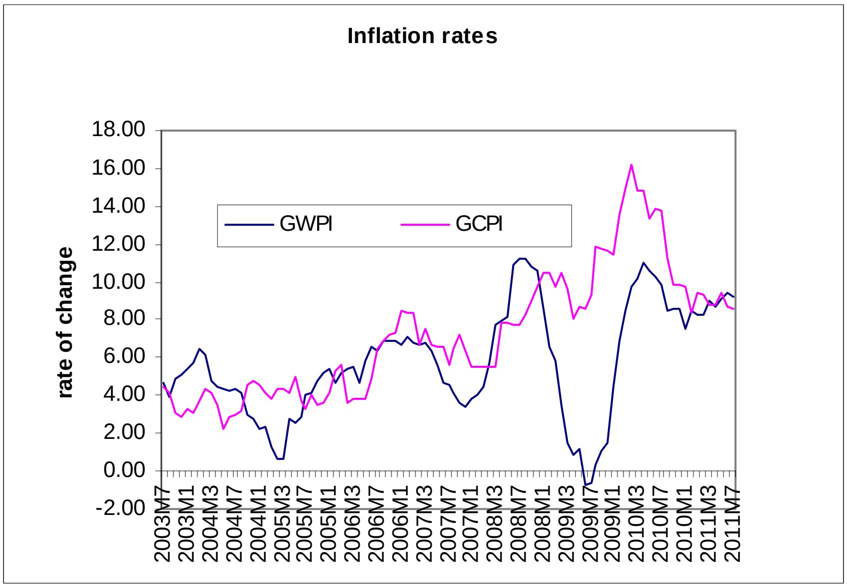
Since last many months, though accelerated food price increase, the increase in input prices for manufacturing, the increasing trend of crude prices and the short-term falling trend of rupee were putting an upward pressure on inflation, the withering of the base effect, the continuing monetary tightening 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. The current uncertainties in the western economies only increasing the oil price fluctuations. The RBI is expected to increase the policy rates further even at the cost sacrificing some growth as the headline inflation continues to hover above the 9 percent mark. On balance, the inflation is likely to marginally go below the psychological 9 percent mark in the next three months.

CPI inflation is sticky almost at the same level

The annual growth in all India Consumer Price Index Number for Industrial Workers marginally came down to 8.62 percent in June from 8.72 percent in May 2011. This is due to the decline in the much sensitive food Inflation to 6.91 percent in June from 7.61 percent in May 2011. Even though the CPI is high for June 2011, it is a steep climb down from the 13.73 percent in June 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 both food and manufactured prices.

Forecast:
The WPI inflation forecasts are 9.08 %,8.96%8 and 8.79% for August ,September and October

2011 respectively. The CPI inflation forecasts are8.69 %,8.71% and 8.59% for July ,August and September 2011 respectively.



Industrial Production

The annual growth of Index of Industrial Production for the month of June has come out at 8.8 percent versus a cumulative growth for the first quarter of 2011-12 stands at 6.8 percent over the corresponding periods of the previous year. The reasonably high growth in June is largely explained by a high rise of 37.7 percent in the growth of capital goods.

Industrial growth is up

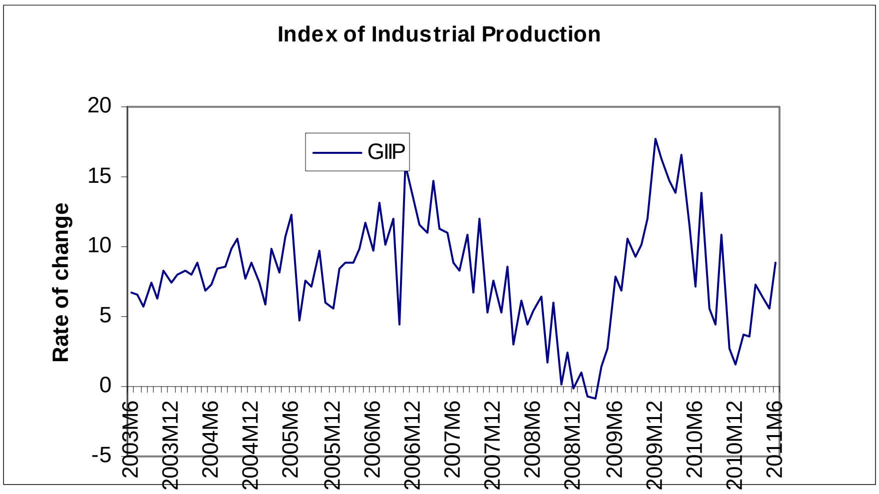
The uptrend in the industrial activity is getting consolidated. The revival in demand is able to deliver this continuous positive growth. However, the pace of growth got tapered off as the low-base effect wears off and the impact of rate hikes and withdrawal of stimulus picked up. The global uncertainties and 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 growths in advance tax collection and in external sector are positive signs for industrial growth. The middle east crisis and the Euro zone crisis are worrying signs in short run. The IIP growth is likely to be around 8.5 percent in next three months.

The Mining, Manufacturing and Electricity sectors for the month of June 2011 grew at 0.6, 10 and 7.9 percents, respectively, as compared to the same month in the previous year. The cumulative growth in these three sectors during the first quarter of 2011-12 has been 1.0, 7.5 and 8.2 percents, respectively. It is a good sign that out of the twenty-two industry groups, fifteen have shown positive growth during June. Industry groups like ‘Electrical machinery & apparatus’, ‘Office, accounting & computing machinery’ and ‘Other transport equipment’ have increased at very high rates of 88.9 percent, 19.1 percent and 18.6 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, unless the supply constraints in Agriculture and Infrastructure sectors 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 June 2011, the annual growth rates in Basic goods and in Intermediate goods are 7.5 percent and 1.9 percent, whereas Capital goods increased by a high 37.7 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 a low 1.6 percent while the Consumer durables grew at 1.0 percent and Consumer non-durables increased at a high 2.1 percent.

Forecast:

Based on the available information we forecast the IIP growth rate for the next three months to be 8.92%,7.4 2% and6.58% for July ,August and September 2011



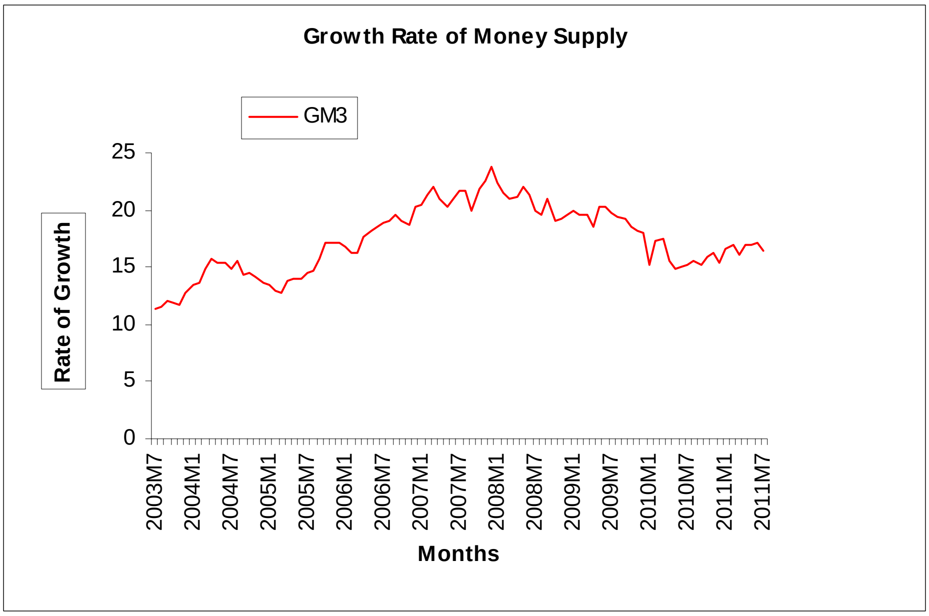
Money and Credit

As on July 29, 2011, Money supply grew annually at 16.4 percent. It is growing around 16 percent since last six months. 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. However, now the credit off take has become sluggish due to high interest rate regime. It is expected that the policy rates may be revised by another 25 basis points in coming September. The expansion in money supply is contributed by the net credit to the Government increasing at 21.4 percent and credit to commercial sector at 18.0 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 S & P downgrade of USA. However, this is a short run problem. The money supply is forecasted to grow at about 16.5 percent for the next three months.

Money supply at 16.4 percent

Forecast:

The forecast for the growth rate of money supply (M3)is16.54 %,16.42% and 16.49% for August ,September and October 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 325 basis points since March 2010 to 8.0 percent. The reverse repo rate is now 7.0 percent. It is a matter of concern that both food and manufacturing prices are going up. 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.

Interest rates are

in upward spiral

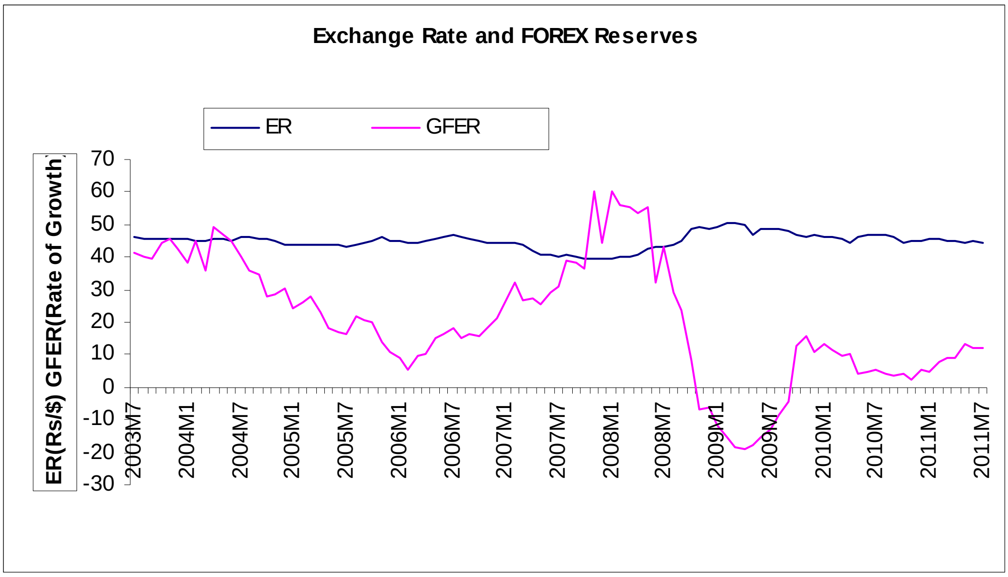
Exchange rate

The monthly average of rupee was 44.7 till August 24, 2011. It was 44.62 till May 20, 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 S & P downgrade of 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 has again started hovering around 46 rupees per dollar as Sensex has started hovering around a shade above the 16000 mark.

Depreciating Rupee

Forecast:

In coming months, exchange rate is expected to be around Rs/$45.24 , Rs/$45.36 and Rs/$45.47 for September, October and November 2011



Foreign Exchange Reserves

Foreign exchange reserves stood at US$ 317.23 billion on August 5, 2011. It was US$ 307.49 billion on May 13, 2011, 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 November19 and US$ 295.03 billion on December 24, 2010. This is a substantial progress from a little over a year ago when reserves reached below 250 billion mark. Recently, it has surpassed marginally 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 marginally higher reserves for the next three months.

Forecast:

Forex reserves expected to be $317.85 billions, $318.26billions and $ 319.05billions in September, October and November 2011

Foreign Institutional Investment

FERs are up

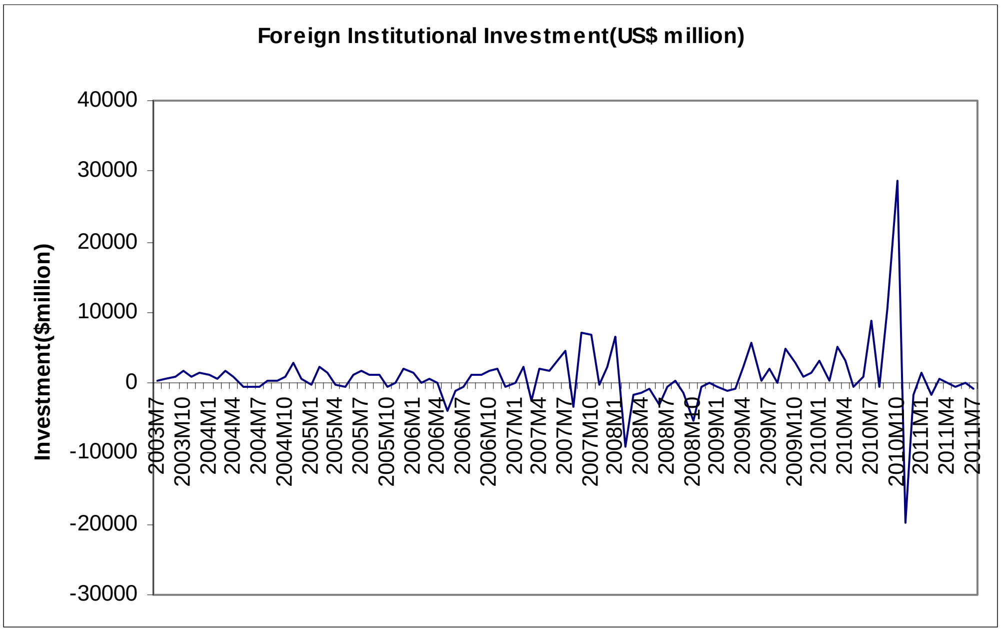
The monthly foreign institutional investments (FIIs) in Indian market was a negative US$ -1790.59 million till August 24, 2011. It was US$ -651.93 million till May 20, US$ 102.98 million till April 8 and US$ -721.13 million for February 2011. This is due to the Eurozone crisis. Whereas the FIIs were 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 few 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.

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, recently, the index is around 16000 due to the repeated hike of policy rates by RBI. 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 in the next three months due to the crisis in the Western economies.

Negative FIIs flows

Forecast:

Inflows are expected to pick up 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 export growth was at a stunning 81.8 percent in July as against a very high growth of 46.5 percent in June 2011. The exports rose at a healthy 36.2 percent during April -June 2011. During April –July 2011 the major contributors to export growth are the sectors like engineering, Gems & Jewellery, and petroleum products. It is expected that the exports would grow at an average of 44 percent in next three month. However, higher inflations at home may not be a good sign for export.

Imports grew by a huge 51.5 percent in July as against a rise of 42.5 percent in June, 2011. In June 2011, non-oil imports grew at 47.8 percent, while oil imports rose by 30.1 percent over the corresponding period last year. Non-oil imports during April - June 2011 are 44.7 per cent higher than the non-oil imports in the same period last year while the figure for oil imports is 18.1 percent. The substantive rise in non-oil imports during last one year shows the demand side is stabilizing at a higher level due to the rapid recovery process in the domestic economy. It is forecasted that the average growth of imports for the next three months will be around 32 percent.

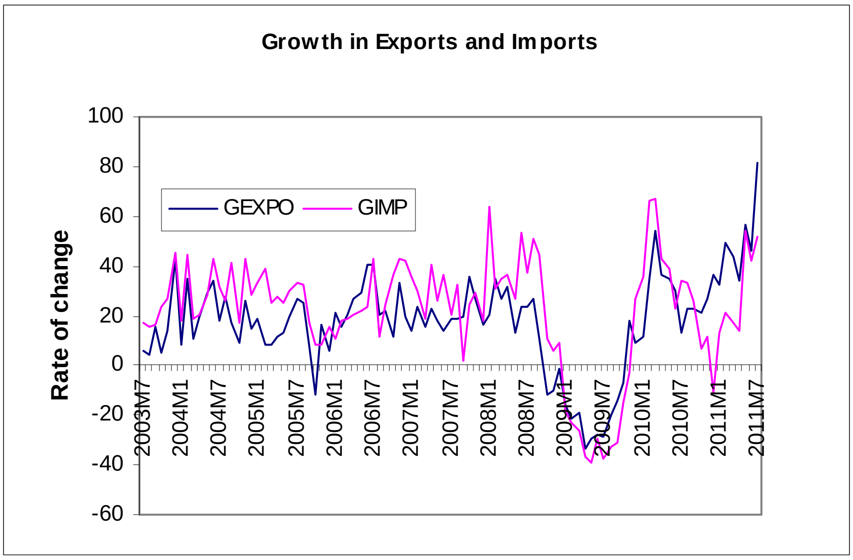
The trade deficit is up at 11.1 billion US dollar in July from 7. 7 billion in June 2011. It was US$ 5.9 billion in June 2011. The trade deficit for April - June, 2011 was US$ 31.6 billion versus US$ 27.0 billion, for the same period, a year ago. The deficit is a concern though it is increasing at a 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 S & P downgrade of USA is a concern for our exports.

Stunning Exports growth

Forecast:

Exports growths forecasts are 49.52,47.53%, 36.28% and the imports growths forecasts are 37.2%,34.4%,25.21% for August, September and October2011

A very high Imports growth



Rising Trade deficit

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 2000 January 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. We have used a revised version of the model presented in this paper. The views expressed in this document are authors alone and not to be attributed to the institute to which the authors belong.