MONTHLY MONITOR

Prepared by
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Index of industrial production shows sign of economic recovery **IIP increased by 9.1 percent** **Inflation now turning positive** **High food prices are complicates macroeconomic management** **Interest rate may remain same**	**Highlights** Index for Industrial Production (IIP) growth stood at a 9.1 percent for the month of September 2009. In the index, the manufacturing sector growth was highest at 9.3% followed by the mining and then the electricity sector. In terms of use based classification, this is contributed by a sharp rise in the growth for capital goods at 12.8% followed by intermediate goods, consumer goods and basic goods. However, the consumer durables recorded an impressive growth of 22.2 percent. These rises in mining sector have been mainly due to the revival of the domestic demand. In terms of industries, increase in the industry group 'Other Manufacturing Industries' was highest at 24.5% followed by the 'Basic Chemicals & Chemical Products (except products of Petroleum & Coal)' and 'Machinery and Equipment other than Transport Equipment'. The upward move is mainly due to the domestic demand induced by government's stimulus measures, salary arrears of government employees and accommodating monetary policies of RBI. The current indicators point towards a healthy growth in the manufacturing sector in the next three months. Continuing its upward trend, the wholesale price index for all commodities increased by 1.34 percent for the month of October 2009 compared with 0.50 percent in the previous month. However the WPI for fuel group decreased by 6.55 percent. Except for the prices of primary food items, growth of prices of other sectors was much less. The prices of food items increased by a sharp 13.32 percent making the macro management of the economy extremely complex. The prices of food items for week ending November 21 increased at a rate as high as 17.47 percent. Money supply continues to grow around 18.1 percent for the month of November. Increases in bank credit to government sector at 41.4 percent still remain a major factor that increases the money supply. The growth in credit to commercial sector and in net foreign exchange assets, which are the other contributors to

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Both exports and imports continues to decline **Forex reserves increase toUS$286.7 billions** **Positive FII flows in September** **Exchange rate may marginally appreciate**	money supply increased by 10.05 percent and 10.2 percent respectively in November 2009. Deceleration in trade sector continues. Both exports and imports growth decelerated by 6.6% and 15.0% in October 2009. However the rate of deceleration has reduced considerably. However as compared to last year the trade deficits have reduced considerably because of steeper fall in imports. As the global economic outlook showing strong signs of recovery, we expect the fall in growth of exports to further slow down in next three months. The oil import bill was 9.3 percent which was lower than the last year rise. But the demand for intermediate imports is expected to go up as the economy is showing the signs of recovery. Foreign exchange reserves continue to rise considerably as compared to year 2008. Currently it is at US$ 286.7 billions. Increase in foreign investments and NRI funds seem to help forex accumulation. The FIIs also turning out to be net buyers. Latest data show that in October 2009, FIIs invested nearly US$ 5 billions. However, the increasing trend in forex reserves and expectation build up for positive foreign institutional investment has led to sharp appreciation of rupee. The exchange rate movement for the month of October and November has led to an appreciation to Rs 46.58 per US dollar.

IEG FORECAST

Variables	Latest Information available	Forecast for next three months
Inflation rate (WPI)	1.34 as in October 2009	2.21%, 2.53%, 2.81%
Inflation rate (CPI)	13.51 in October 2009	11.17%, 10.78 %, 10.26%
Growth rate of IIP	9.1% in September 2009	9.21%, 8.87%, 8.72%
Growth rate of M3	18.1% for November 2009.	18.38%, 18.29%, 18.16%
Prime lending rate	11-12 % as on November 2009.	Around 11%
Re/$ exchange rate	46.58 as on November 2009	46.36, 46.25, 45.98
Forex reserves	US$286.7 billions as on 27 Nov 2009	$298.32, $311.76, $320.21
FII inflows (Net)	US$ 4999millions in September 2009	Inflows to be positive
Growth rate of exports	-6.6% for October 2009	-5.02%, -2.21%, -0.20%
Growth rate of imports	-15% for October 2009	-15.92%, -11.30%, -9.24%

Inflation

WPI for all commodities increased by 1.34%

Continuing its upward trend, the wholesale price index for all commodities increased by 1.34 percent for the month of October 2009 compared with 0.50 percent in the previous month. However the WPI for fuel group decreased by 6.55 percent. Except for the prices of primary food items, growth of prices of other sectors was much less. The prices of food items increased by a sharp 13.32 percent making the macro management of the economy extremely complex. The prices of food items for week ending November 21 increased at a rate as high as 17.47 percent.

CPI increased by 13.51%

The rises of vegetables prices are affecting the common people. The prices of food rose by 13.32 percent, rise of potato and onions was highest, and similar is the case with pulses, rice and wheat. On the other hand prices of non-processed food items declined. One of the reasons why food prices are going up in the recent months may be due to floods in Karnataka and Andhra Pradesh that damaged the standing Kharif crops creating short term lag in supply. Prices of food may come down if the Rabi harvest is bountiful as expected.

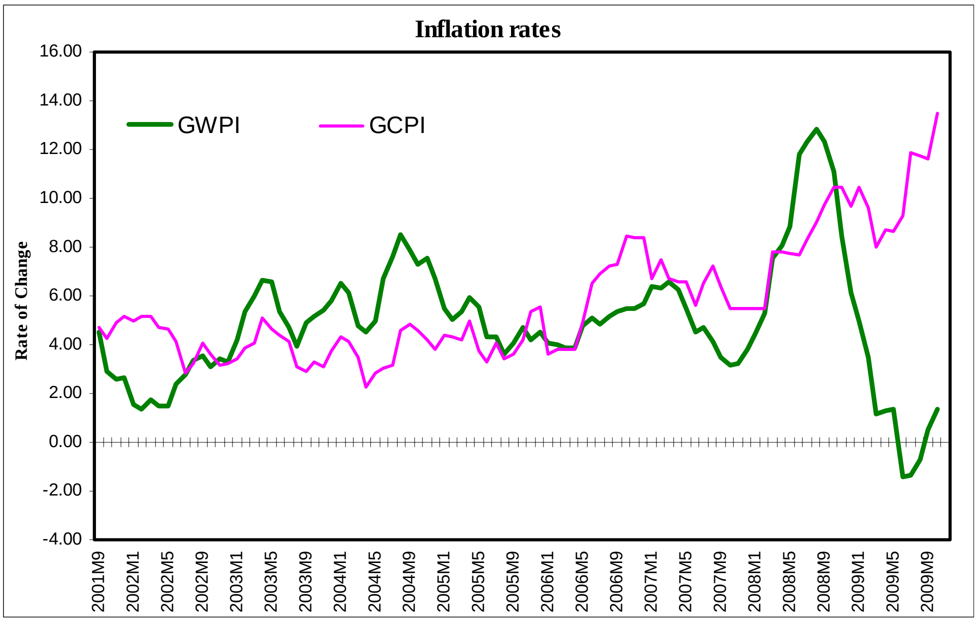
Food inflation is very high

Even though the GDP growth for second quarter gave a positive surprise, the high food inflation continues unabated. Food inflation has reached 17.5 percent according to the latest release. The agriculture growth is expected to be negative for the third quarter even though it was positive at 0.9 percent in the second quarter. It is expected that government and RBI may intervene soon.

Consumer Price Index (CPI) increased again by a high 13.51 percent for the month of October 2009.

Forecast:

The WPI inflation forecast for the next three months are 2.21% for November and 2.53% for December and 2.81% for January 2010 respectively.



Industrial Production

IIP was marginally lower as compared to August figure

Index for Industrial Production (IIP) growth stood at a 9.1 percent for the month of September 2009. In the index, the manufacturing sector growth was highest at 9.3% followed by the mining and then the electricity sector. In terms of use based classification, this is contributed by a sharp rise in the growth for capital goods at 12.8% followed by intermediate goods, consumer goods and basic goods. However, the consumer durables recorded an impressive growth of 22.2 percent. These rises in mining sector have been mainly due to the revival of the domestic demand. In terms of industries, increase in the industry group 'Other Manufacturing Industries' was highest at 24.5% followed by the 'Basic Chemicals & Chemical Products (except products of Petroleum & Coal)' and 'Machinery6 and Equipment other than Transport Equipment'.

Manufacturing industries were the main contributor to the growth in IIP

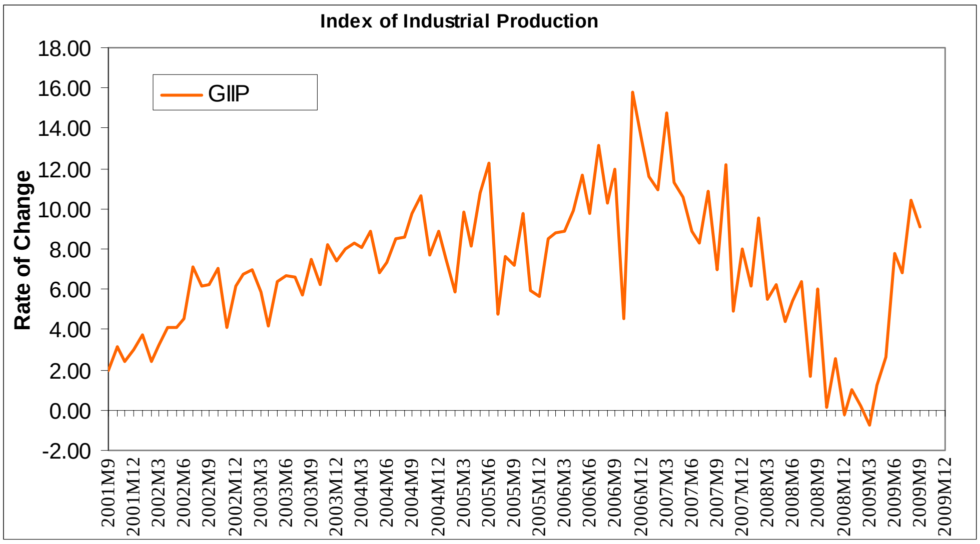
The upward move is mainly due to the domestic demand induced by government's stimulus measures, salary arrears of government employees and accommodating monetary policies of RBI. The current indicators point towards a healthy growth in the manufacturing sector in the next three months.

All indicators so far point to continuing healthy growth in the manufacturing sector for the next three months.

The recessionary trend in the economy is fading

Forecast:

Based on the available information we forecast the IIP growth rate for the next three months to be 9.21% for October, 8.87% for November and 8.72% for December 2009.



Money and Credit

Money supply grew at 18.1 percent

Money supply growth for the month of November 2009 was 18.1 percent which is less than the growth rate of money supply of 19.4 percent as in August. Increases in bank credit to government sector still remain a major factor that increases the money supply. The growth in credit to commercial sector and in net foreign exchange assets, which are the other contributors to money supply increased by 10.05 percent and 10.2 percent respectively for November month.

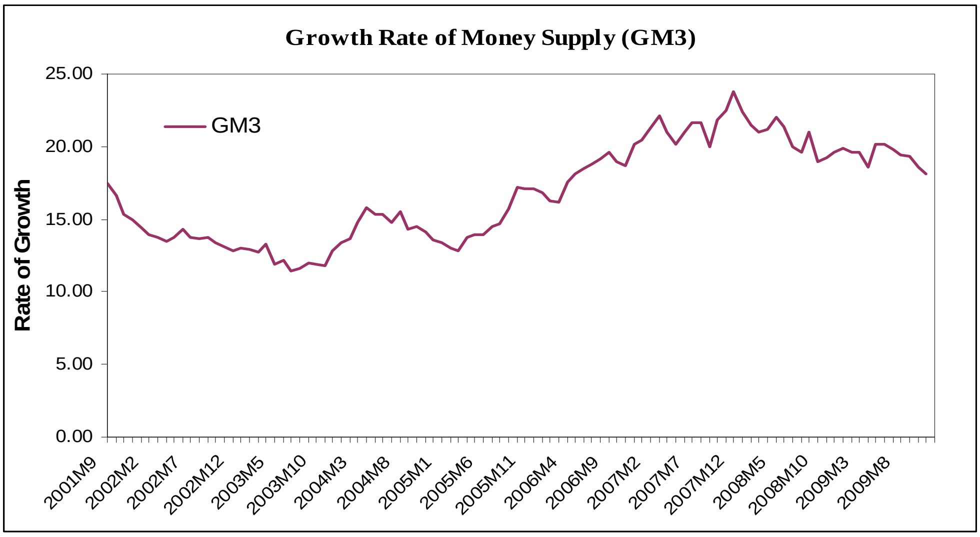
Credit to government sector increased by 41.5 percent.

This remained major factor in increasing M3 supply in the economy

Among the components of money supply as measured by M3, the time deposits and demand deposits increased. Also currency with the public increased moderately. However the other deposits with reserve banks registered a decline.

Forecast:

The forecast for the growth rate of money supply (M3) is 18.38% for December, 18.29 % for January 2010 and 18.16% for February 2010.



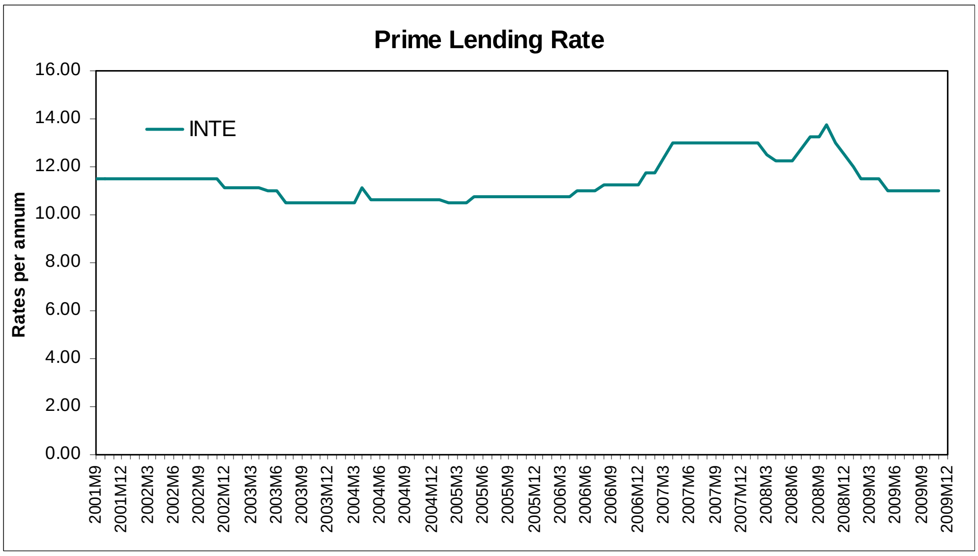
Interest rates

The low policy rates and past deflationary expectations were supposed to put downward pressure on the lending rates. However, as the transmission of reduction in the policy interest rates to prime lending rates appears to be very weak, market rates have not seen much change as was expected. Currently the prime lending rates as per RBI data as in October 2009 is in the range of 11 to 12 per cent.

The inflation rates (WPI) has turned positive in the first half of September and keeping on increasing. The expected deceleration in agriculture sector in the third quarter of current fiscal year has added to the build-up of the inflationary expectation by putting huge pressure on food prices. However, pressures are on the central bank to hold the policy rates at the current levels as the recovery signs are still not full fledged. In fact, the policy rates may be revised upwards if the positive signs of the revival of the economy sustain itself for a few months more. Thus the macro economic management of the economy is becoming increasingly complex. On balance, we predict a marginal decline in the PLRs in the next three months.

Forecast:

The Prime Lending Rates(PLR) are forecasted to stay around 11 percent for the next three months



Exchange rate

Exchange rate appreciated

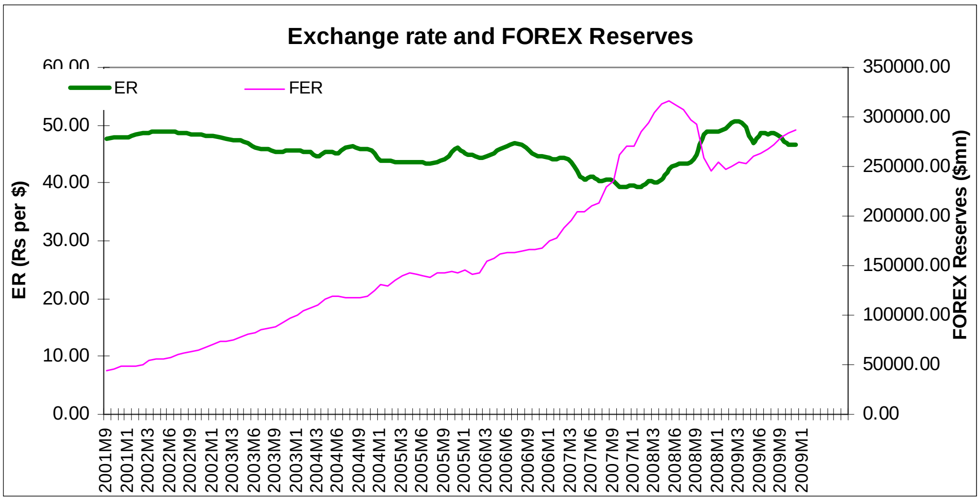
The Rupee versus US dollar exchange rate has appreciated to 46.58 in November 2009 as compared to 48.5 in August 2009. This marginal appreciation was mainly due to the positive inflow of foreign capital to India that has led to expectations build up for further inflows into the country. This process would help in building up foreign exchange reserves, thus strengthening rupee in external market. However, this appreciation of rupee, both ongoing and expected, would have a negative impact on the export sector.

The rupee appreciation was mainly due to economic recovery

The Rupee/US dollar exchange rate has appreciated by Rs 2.07 in the said period. During this period Rupee is volatile which further affect our export sector. On the other side industrial production is showing strong revival signs and huge investment by FII in stock market. This appreciation was mainly due to economic recovery.

Forecast:

In coming months, exchange rate are expected to be around 46.36 Rs/$ for December, 46.25Rs/$ for January and 45.98Rs/$ for February2010.



Foreign Exchange Reserves

Accumulation in foreign exchange reserves

The foreign exchange reserves continue to get accumulated. In the month of October 2009, the reserves were recorded at US $ 284.39 billions which are higher than the month of September 2009 when the reserves were at US $ 280.9 billions. Further, the reserves increased to US$286.72bn in the week ended November 27, according to the latest release by the RBI.

Foreign fund inflows helped in this accumulation

However, as compared to September 2009, the rise in reserves is indicates inflows of foreign investment into Indian market. The 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 also increasing in the Indian market. The rise in stock market indices is also attracting FII inflows. However, the high government deficit, which is to continue for sometime, could dampen the inflow of foreign funds. Besides, as the oil prices are firming up, the high oil import bill could also restrain the accumulation of reserves. The positive signs of world economic recovery is also firming up commodity prices which will lead to squeezing of reserve accumulation.

Forecast:

Forex reserves expected to be $298.32 billion for December, $311.76 billions for January and $320.21 billions for February 2010

Foreign Institutional Investment

FIIs increased to

The foreign institutional investments (FII) in Indian market were around US $4999 millions in September 2009 alone. This was mainly due to proactive government policies that helped in easing the rules and regulation for foreign funds. The revival in major global

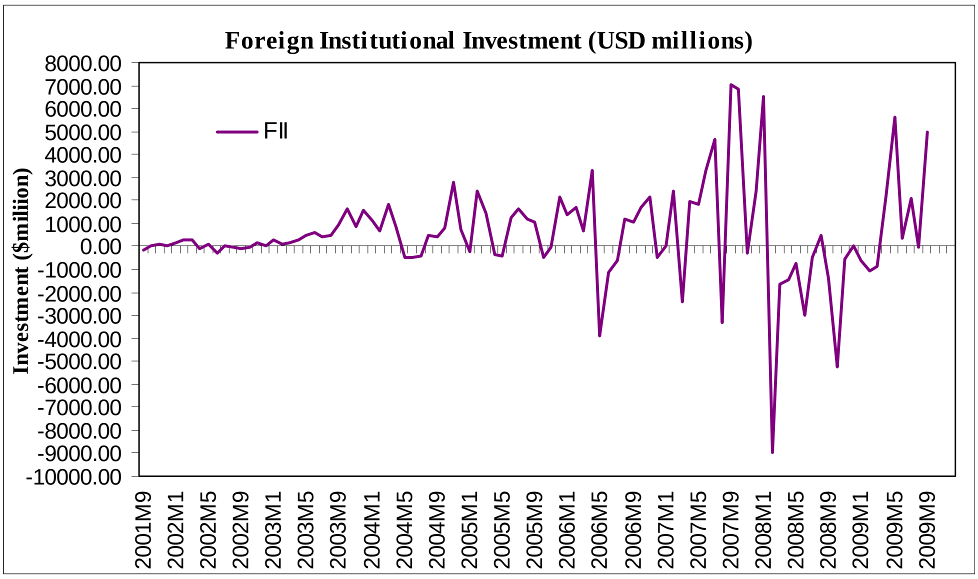
nearly 5 billion in September 2009

economies along with the improvement in Indian share markets has reversed the earlier negative trend of foreign institutional investments in the economy. The positive net foreign flows are mainly due to strong revival signs in the Indian economy which is reflected in the current growth in IIP numbers, and due to the interest rate differentials. As far as stock market is concerned Bombay Stock exchange Sensex is hovering around 17,000 mark recently showing renewed confidence of Indian as well as foreign investors.

This was mainly due to proactive government policies that helped in easing the rules and regulation for foreign funds

Forecast:

Inflows are expected to be positive n next three months



Exports and Imports

Exports and Imports are decelerated again for the consecutive months

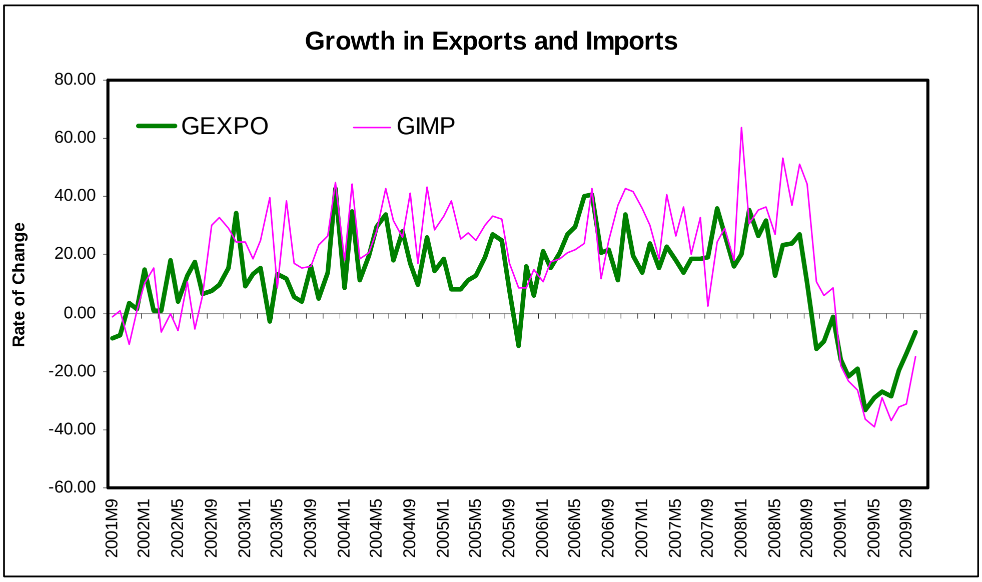
Indian exports decelerated again by 6.6 percent. Also the imports fell by 15.0 percent for October. The fall has considerably slowed down and, in the month of October 2009, it registered a decline of 6.6 percent, a big improvement from its steepest decline of 39.2 percent in May 2009**.** The sluggishness in the external demand following recessionary trends in industrialized nations and large base effect has resulted in this sustained negative growth in exports. As the global economic outlook is improving, it is expected that the exports would decline further but at a much slower rate in the next three months and may turn positive afterwards. The government is planning to provide some incentives to a few selected sectors which expected to have positive impact on the export sector, especially in view of the recent Dubai crisis as Dubai has emerged as one of the major export destinations for India as well as the continuing appreciation of rupee versus US dollar.

Imports fell by 15 percent and exports by 6.6

percent	Imports also continued to decline for seventh consecutive months. Imports declined by a sharp 15 percent, at a steeper rate than exports and thus, reducing the trade deficit, reflecting the slowdown in domestic consumption and decrease in oil imports bill. The oil imports bill reduced by 9.3 percent and non-oil imports fell by 17.2 per cent in October 2009. As oil prices have gone up to around US$ 75, in the world market, oil import bill has started getting inflated slowing down the decline, and this
Decrease in oil import bills	trend is likely to continue. Even if the stimulus packages are enfolding well as reflected in the July-September 2009 GDP growth rate the non-oil imports still declined at fast pace. However, the demand for intermediate imports is expected to go up as the economy is showing the signs of recovery. The larger negative trend in imports has resulted in
Trade deficits narrowed down considerably	narrowing of trade deficit and the deficit is predicted to decline further. Moreover, the most impressive figure is the decline in trade deficits considerable. The steeper fall in imports and lesser decline in exports have helped reduce the trade deficit considerably as compared to last year.

Forecast:

Exports are forecasted to decline by -5.02% -2.21% and -0.20%, and imports by -15.92%, -11.30% and -9.24% for November 2009, December 2009 and January 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**

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