# MONTHLY MONITOR

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**October 2010**

Highlights

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|---|---|
| ***Industrial growth cools down*** | **The annual growth of Index of Industrial Production for the month of August has come out at 5.6 percent versus 13.8 percent in July 2010, and is largely explained by the 2.6 percent decline in capital goods sector. The capital goods increased at a whopping 63 percent in July 2010. The industrial activity is cooling down after many months of high growth. The recovery has also become more broad-based with 14 out of 17 industry groups recording positive growth in August 2010 as well as during the whole of 2009-10.** |
| ***WPI inflation increases marginally*** | **Inflation rate (WPI) stood at 8.62 in September 2010 as compared to 8.51 percent for the previous month, mainly due to increase in prices of food articles. The rapid growth of IIP, the slow growth of agriculture and the low base effect explains this high inflation for the last many months.** |
| ***Consumer Price inflation declined marginally*** | **The annual growth in all India Consumer Price Index Number for Industrial Workers came down marginally to 9.82 percent in September, 2010 from 9.88 percent for August, 2010.** |
| ***Rupee appreciated sharply*** | **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 44.45 per dollar in October 2010. It is forecasted to be about 44 for the next three months riding on the expected foreign flows.** |
| ***FII flows are at high US$ 5468 million*** | **The foreign institutional investments (FII) in Indian market were US$ 5468 million in October 2010. The FII were US$ 4263 million in September, US$ 3083 million in August, US$ 5285 million in July and US$2434 million in June 2010. These impressive figures clearly show the foreign investors' confidence about India's long term growth prospects. The expected medium term appreciation of rupee and the prospects of returns increasing further are forming a virtuoso cycle. The recent decision of the Federal reserve to buy $600 billion in government bonds will also stimulate the flows to India.** |
| | **India's exports after growing at a very high pace in past few months are slowing down, though it grew at a healthy 23.2** |

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| *Growths in Exports rises, and in imports slows down, and trade deficit at 9.12 billion* | **percent in September 2010, 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 at a higher rate due to steep increase in non-oil imports on the back of high domestic demand. The imports expanded at 26.1 percent in dollar terms in September 2010. The trade deficit widened at 1.3 percent in September 2010 to US$ 9.12 billion from US$ 6.9 billion in a year ago.** <br><br> . |

## IEG FORECAST

| Variables | Latest Information available | Forecast for next three months |
|---|---|---|
| **Inflation rate (WPI)** | 8.6% in September 2010 | 8.83%, 8.56%, 7.84%. |
| **Inflation rate (CPI)** | 9.82% in September 2010 | 9.68%, 8.78%, 8..59% |
| **Growth rate of IIP** | 5.6% in August 2010 | 7.92 %, 6.32%, 7.42% |
| **Growth rate of M3** | 15.8% on October 8th, 2010. | 15.88 %, 15.93 %, 15.99% |
| **Re/$ exchange rate** | . 44.45 in October,2010 | 44.15, 44.30, 44.06 |
| **Forex reserves** | US$ 295.40 billion on October,2010 | $298.99, $301.06,$309.98 |
| **FII inflows (Net)** | US$5468.36million in October, 2010 | Inflows for the next three months are to be high |
| **Growth rate of exports** | 23.2% for September 2010 | 20.14%,19.87%,16.89% |
| **Growth rate of imports** | 26.1% for September 2010 | 28.53%,26.83%,27.79% |

*WPI inflation increased marginally*

*CPI declined marginally*

## Inflation

Inflation rate stood at 8.62 in September 2010 as compared to 8.51 percent for the previous month, mainly due to increase in prices of food articles, 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.

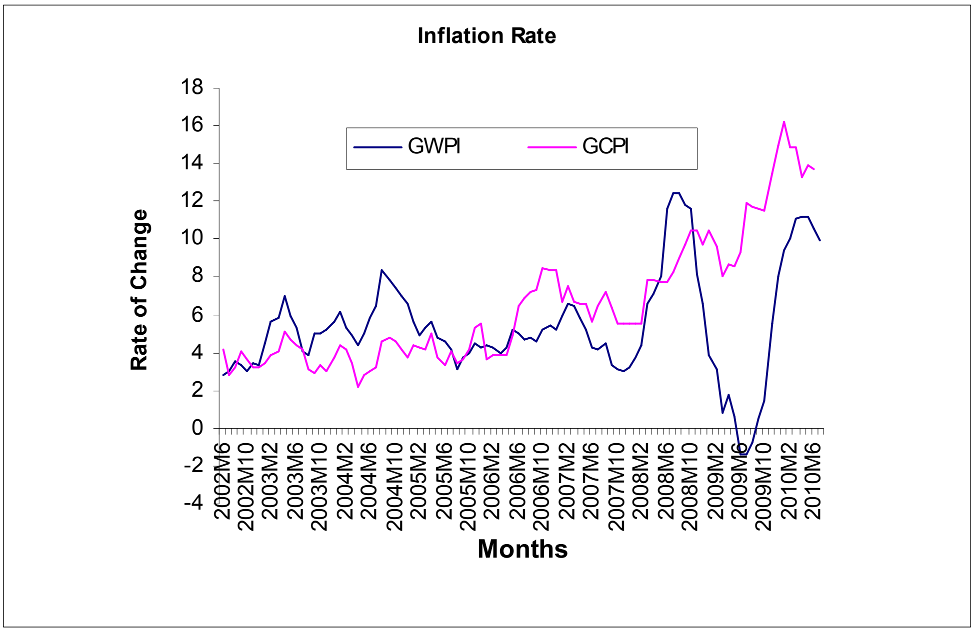
The primary articles index with a weight of 20.12 percent was up by 1.5 percent in September 2010 over the previous month while the index for fuel, power, light and lubricants with a weight 14.91 percent was down by 0.3 percent, and the index for the major sector, the manufacturing products with a weight of 64.97 percent increased by 0.3 percent.

The marginal increase in inflation indicates a cooling down of inflationary expectations. 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 further. On the other hand, the high GDP growth along with the 26.5 percent growth of consumer durables 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.

The annual growth in all India Consumer Price Index Number for Industrial Workers came down marginally to 9.82 percent in September, 2010 from 9.88 percent for August, 2010. It was 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. 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 that the growth rates in CPI will come down further the next three months.

***Forecast:***

*The WPI inflation forecasts are8.83 %, 8.56%, and 7.84% for October, November and December, 2010, respectively. The CPI inflation forecasts are 9.68%, 8.78% and 8.59% for October, November and December 2010, respectively.*




## Industrial Production

The annual growth of Index of Industrial Production for the month of August has come out at 5.6 percent versus 13.8 percent in July 2010, and is largely explained by the 2.6 percent decline in capital goods sector. The IIP grew at 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.

***Industrial growth cools down***

The uptrend in the industrial activity is getting consolidated. The cumulative growth for the period April-August 2010-11 is 10.6 percent over the same period in the last year. The recovery has also become more broad-based with 14 out of 17 industry groups recording positive growth during the year 2009-10. During August 2010 also, out of 17 groups, 14 groups showed positive growth. 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 week. The IIP growth is likely to hover around 8 to 6 percent in next three months due to the base effect and the 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 slow IIP growth at 5.6 percent***

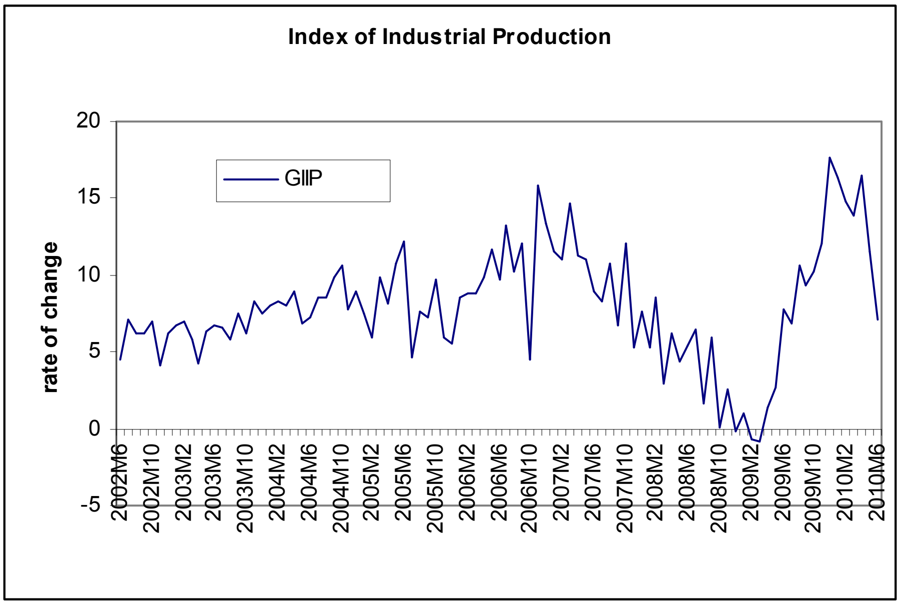
The Mining, Manufacturing and Electricity sectors for the month of June 2010 grew at 7.0 percent, 5.9 percent and 1.0 percent, respectively, as compared to the same month in the previous year. Some industry groups like 'Metal

Products and Parts, except Machinery and Equipment', 'Other Manufacturing Industries' and 'Transport Equipment and Parts' have helped the IIP to maintain its positive trend. 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 and in Intermediate goods are 3.7 percent and 10.0 percent, where as Capital goods declined by 2.6 percent in August 2010. The low Capital goods growth is not good sign for sustaining the over all growth rate in the economy. The Consumer goods grew at 6.9percent in August 2010 while the Consumer durables grew at 26.5 percent and Consumer non-durables declined at1.2 percent.

***Forecast:***

*Based on the available information we forecast the IIP growth rate for the next three months to be 7.92%,6.32% and 7.42% for September, October and November2010.*



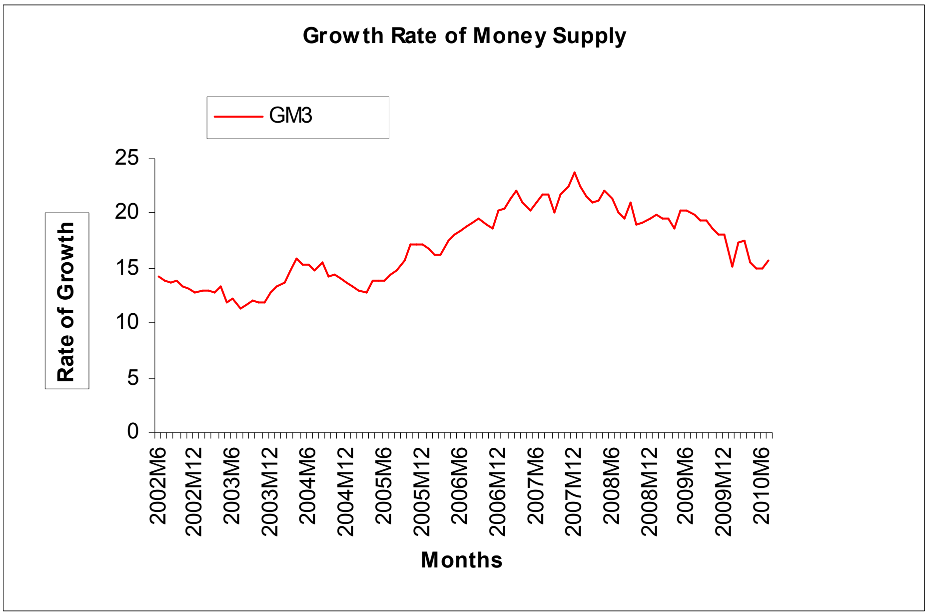

## Money and Credit

***Money supply at 15.8 percent***

As on October 8, 2010, Money supply grew at 15.8 percent as against 19.5 percent in the previous year. It grew at 15.6 percent in September 10 as against 14.5 percent June18 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 has received from the 3 G and broadband auctions have slowed down the borrowing program of the government this fiscal. The expansion in money supply is mainly contributed by credit to the commercial sector. The change in net foreign assets is marginally negative. The bankers are predicting that the credit off take is likely to pick up in the second half of this financial year. The FIIs have started pouring in money to India reaffirming their faith into its growth prospects. The government has increased the FII limits recently. More money is expected from abroad as the previous cap of $5 billion has already been breached on government securities. The money supply is forecasted to grow at about 16 percent for the next three months.

***Forecast:***

*The forecast for the growth rate of money supply (M3) is15.88 %, 15.93% and 15.99 % for November, December2010and January 2011*




## Interest rates

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. Government's recent move to increase the FII limit in debt market from US$20 billion to US$30 billion and slash its borrowing plans substantially will have a softening effect on the market interest rates. However, the prime lending rates are also seeing upward revision. 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. 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.

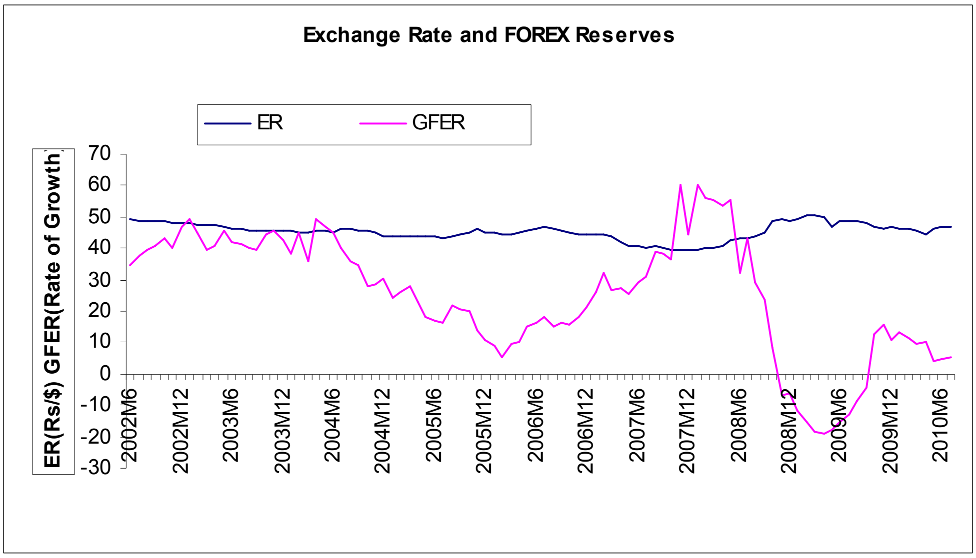
## Exchange rate

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 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 44.45 per dollar in October 2010. It is forecasted to be about 44 for the next three months riding on the expected foreign flows.

***Rupee appreciated sharply***

***Forecast:***

*In coming months, exchange rate is expected to be around Rs/$44.15, Rs/$44.30 and Rs/$44.06 for November, December 2010 and January 2011*




## Foreign Exchange Reserves

Foreign exchange reserves stood at US$ 295.44 billion on October 22, 2010. It was US$ 291.60 billion on September 24, US$ 283.88 billion in August 31, 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 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 attracting huge FII inflows. 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. More money is expected from abroad as government has recently increased the FII limit in debt market from US$20 billion to US$30 billion and the previous cap of $5 billion has already been breached on government securities. However, if the world economy grows at the predicted rate, the high oil import prices could restrain the accumulation of reserves. The likely outflow of Indian FDI to other countries could also restrain the accumulation. On balance, we forecast a high and sustained rise in the next three months.

***Foreign Exchange Reserves at healthy US$ 295.4 billion***

***Forecast:***

*Forex reserves expected to be $298.99 billions, $301.06 billions and $309.98 billions in November December 2010and January 2011*

## Foreign Institutional Investment

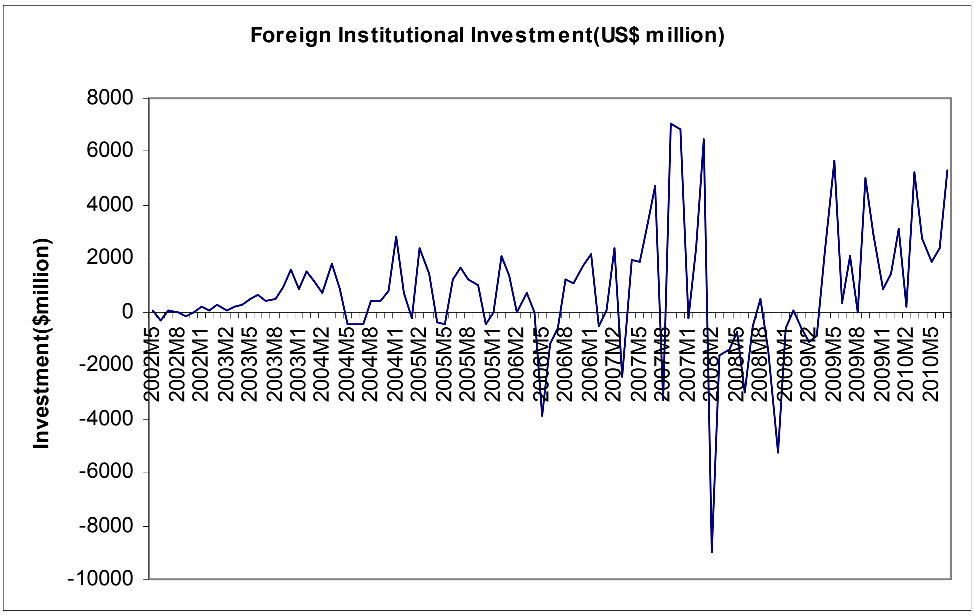
The foreign institutional investments (FII) in Indian market were around US$ 5468 million in October 2010. The FII was US$ 4262.60 million in September, US$ 3082.75 million in August, US$ 5285.33 million in July and US$2433.99 million in June 2010. These figures clearly show the foreign investors' confidence about India's long term growth story. The expected medium term appreciation of rupee and the prospects of returns increasing further are forming a virtuoso cycle. The recent decision of the Federal reserve to buy $600 billion in government bonds will also stimulate the flows to India.

***FII flows are at high US$ 5468 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 started recovering and is hovering above the high 20,000 mark recently showing renewed confidence of Indian as well as foreign investors. The current global cues are also conducive which may push the Sensex higher. It is forecasted that the growth in flows is likely to be high for the next three months.

***Forecast:***

*Inflows are expected to be high for 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 export growth was at 23.2 percent in September at US $ 18.02 billion where as it grew at 22.5 percent in August and only at 13.2 percent in July 2010 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. 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 20.14 per cent in next month. This lower forecast, despite the recent stimulus majors by government to increase exports, is mainly due to the not so encouraging global scenario.

***Exports rises to 23 percent***

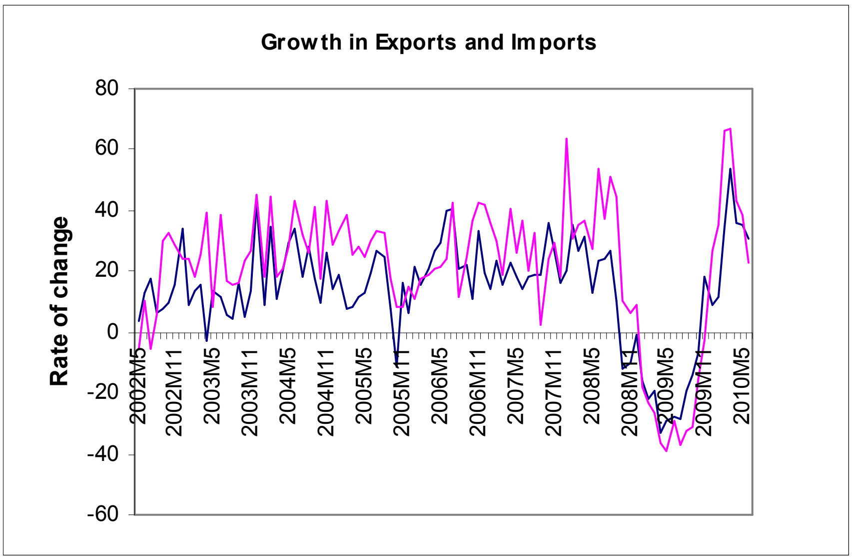
Imports rose at 26.1 percent in September, 2010 at $ 27.14 billion where as it grew at 32.6 percent in August, at 34.3 percent in July, at 23 percent in June and at 38.5 per cent in May 2010. In September 2010, oil imports grew at 14.4 percent over the corresponding period last year, while non-oil imports grew at 31.2 percent. Non-oil imports during the first half of the current financial year is 29.9 per cent higher than the level of such imports in the same period last year. The substantive rise in non-oil imports during last six months shows the demand side is stabilizing at a higher level due to the rapid recovery process in the domestic economy.

The trade deficit widened at 1.3 percent in September 2010 to US$ 9.12 billion from US$ 6.9 billion in a year ago. The deficit was US$13.06 billion in August, 2010, 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 larger positive trend in imports has resulted in widening of trade deficit against the last year. The imports are forecasted to increase at a faster pace than the exports resulting in a higher deficit.

***Imports stood at 26.1 percent***

### *Forecast:*

*Exports growths are forecasted as 20.14%, 19.87 % and 16.89% for October, November and December 2010 respectively. Imports are expected to increase by 28.50%, 26.83% and 27.79% for October, November and December2010 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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