# MONTHLY MONITOR

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## TOP STORIES

***Economy registered 8.1% GDP growth in the first quarter of 2005-06***

Indian economy has registered a strong GDP growth of 8.1% in the first quarter of current fiscal year compared to 7.6% in the previous year. This is backed by growth in both industrial and services sectors, which have grown at 9.6% and 9.8% respectively. Although agricultural sector has shown a growth of 2%, its share in total GDP fell below 20% for the first time.

***For the whole of 2005-06, we forecast the GDP growth at 7%***

For the whole of 2005-06, we forecast the GDP growth to be at 7%. Although both industry and services sectors are expected to be growing below compared to 2004-05, it is still above the average growth. Agriculture sector is expected to do better this year, particularly in the rabi season, compared to last year. Current growth of above 9% in industrial sector may not be sustainable for the whole year and is expected to grow at 72%.

| Output | Q1 2004-05 | Q1 2005-06 | 2004-05 Revised | 2005-06 Forecast |
|---|---|---|---|---|
| **Agriculture** | 3.8 | 2.0 | 1.1 | **3.2** |
| **Industry** | 7.1 | 9.6 | 7.6 | **7.2** |
| **Services** | 9.5 | 9.8 | 8.9 | **8.1** |
| **GDP** | 7.6 | 8.1 | 6.9 | **7.0** |

***IIP growth in July 2005 dipped to 6.7% due to floods in West of India.***

The growth of index of industrial production fell to 6.7% in July 2005 compared to 11.7% in the previous month. Negative growth in both mining and electricity sectors (by 0.4 and 1.2 percent respectively) has led to this fall in overall IIP growth. This fall in IIP growth could be an aberration as this is the consequence of devastating rainfall in the West of India. But the overall growth in industrial sector for 2005-06 is dependent on the external demand.

***WPI inflation started rising.***

***Inflationary expectations still***

As predicted in our previous issue of Monthly Monitor, the WPI inflation started rising. It has gone up to 3.75 percent in the middle of September 2005 compared to 3.13 percent in the second week of August 2005. This rise is not only due to recent hike in the domestic fuel prices, but also is fuelled by the rise in the prices of fruits and vegetables, sugar group, cement and iron & steel

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***persists in the economy.***

prices (all above 8 percent). Given the growing money supply and high world oil prices, inflationary expectations still persists in the economy.

***Money supply growth rises due to growing credit off-take.***

Money supply growth has started rising. Currently M3 is growing at 15.7%, which is mostly due to growing non-food credit to commercial sector backed by the strong business confidence. This growth in M3 is despite the decline in the pace of forex accumulation. As we expect no further rise in the forex reserves, money supply growth is expected to stabilize at 15.5% in the coming months.

***Forex reserves declined marginally.***

***Exchange rate may depreciate further.***

As we rightly predicted in the previous issue of Monthly Monitor, forex reserves declined marginally and also the exchange rate depreciated. Forex reserves are at US$143.01 billions, while Rupee/US dollar exchange rate depreciated to 44.23 by the beginning of October 2005. Narrowing interest rate differentials and expected increase in the Dollar demand due to widening trade deficit must have led to this depreciation. Due to same reasons, we expect a small decline in forex reserves and also depreciation of exchange rate in the coming months.

***Strong growth in trade sector continues***

***But widening trade deficit is a cause for concern***

India's exports continue to register double-digit growth for the fifth consecutive month. In August 2005, it has achieved a growth of 25%. Growing India's export competitiveness and the demand from the recovering World economy must have sustained this double-digit growth. Imports also showed a strong growth of 32.44% in August 2005. One worrying factor could be the rising trade deficit, which is at US$6.2 billions in the first quarter of current fiscal year. This is almost close to the trade deficit of whole of last year. Trade deficit is expected to widen as the World oil prices is expected to remain at its high level.

# IEG-DPC Forecast

| Variables | Latest Information available | Forecast for next Three months |
|---|---|---|
| Inflation rate (WPI) | 3.75% in September 2005. | Expected to be above 4% |
| Inflation rate (CPI) | 3.45% in August 2005 | Rise marginally |
| Growth rate of IIP | 6.7% in July 2005 | 8% (average) |
| Growth rate of M3 | 15.7%in September 2005. | 15.5% (average) |
| Prime lending rate | 10.25 – 10.75 % in September 2005. | Lending rates to rise |
| Re / $ exchange rate | 44.23 on 4th October 2005. | Between 44.2 to 44.5 |
| Forex reserves | US $ 143.01 billions in September 2005. | Expected to decline marginally |
| FII inflows | Inflow of US$1,222 millions in June 2005. | Positive inflows |
| Growth rate of exports | 24.91% in August, 2005 | 15.2% (average) |
| Growth rate of imports | 32.44% in August, 2005 | 20.6% (average) |

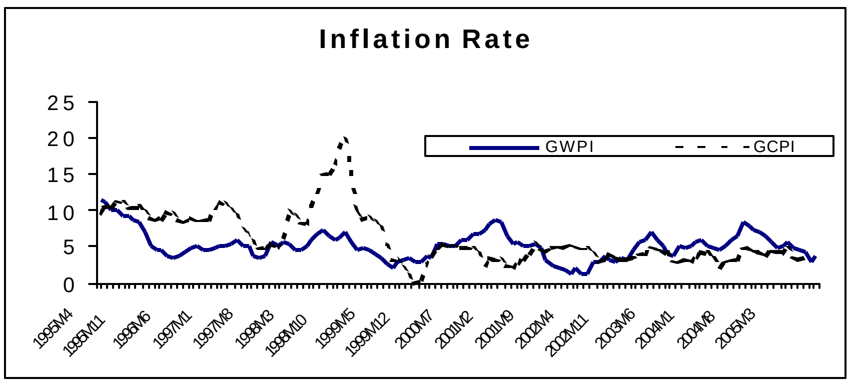
## Inflation

***The WPI inflation started rising.***

***Fruits and vegetable prices increase by 8%***

***Inflation is expected to rise further.***

The inflation rate based on WPI started rising. The inflation rate has gone up to 3.75 percent in the middle of September 2005 compared to 3.13 percent in the second week of August 2005. This rise was expected due to the recent hike in the domestic fuel prices, which has gone up by 11.3 percent. Added to this, rise in the prices of fruits and vegetables, sugar group, cement and iron & steel prices (all above 8 percent) has led to this upward movement in the general price level. Further, the liberal monetary policy, which is reflected in the rise of money supply growth, and the existing high world oil prices would result in further rise in inflation rate in the coming months. However, the rate of inflation, based on the CPI (industrial workers) has decreased from 4.06 percent in July 2005 to 3.45 percent in August 2005. In August 2004, it was 4.61 percent. But the impact of rising wholesale prices would be certainly reflected in the retail prices, although with a lag.




### *Forecast:*

**Based on the available information we forecast the WPI inflation for the next three months to be 4.15%, 4.4%, and 4.8% and the CPI inflation rate to hover around 3.6%.**

## Industrial Production

***Industrial sector growth declines***

***Floods in Mumbai and other parts of West India takes toll on industry***

Industrial sector, after registering double-digit growth for two consecutive months, has declined to 6.7 percent in July 2005 compared to 11.7 percent in the previous months. It was 8.5 percent in the same period last year. This is majorly due to negative growth in both mining and electricity sectors (by 0.4 and 1.2 percent respectively). Although manufacturing sector did grow at 8.3 percent, this is much less than its previous performance in the current fiscal. Among the Use-based classification, both Capital goods and the Consumer goods (particularly the consumer non-durables) continued to experience robust growth. The current fall in the IIP growth might be due to incessant rainfall and floods in West of India that crippled the economy. Given the positive sentiments in

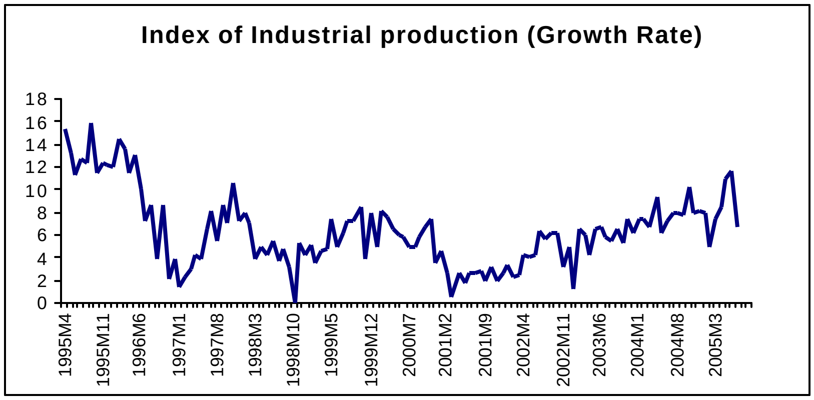
*This drop might be an aberration, but IIP growth could not be more than 8%*

the economy and expanding credit to commercial sector, it appears that the IIP growth in July 2005 might be an outlier in the current high growth path. But, for the whole of 2005-06, the growth may not exceed 8 percent despite growing external demand due to some cyclical factors.

**Forecast:**

*Based on the available information we forecast the IIP growth rate for the next three months to be 8.3,8.0 and 7.9 percent respectively.*

*Recovery in the industrial sector to continue.*




**Money and Credit**

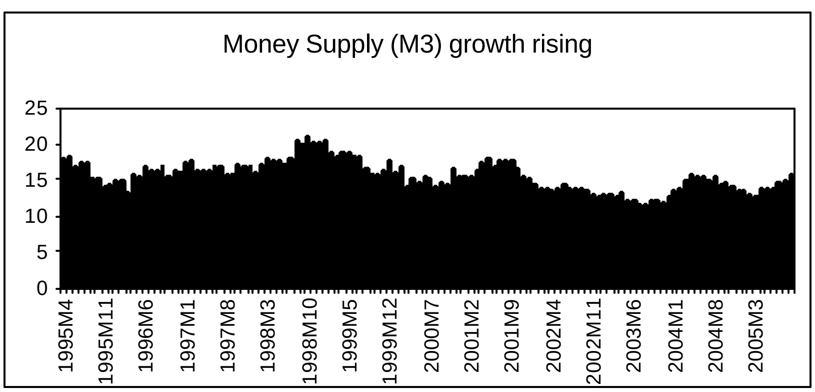
*Money supply growth rises due to high credit off-take*

Money supply growth continues to increase. By the middle of September 2005 it has registered a growth of 15.7 percent compared to 14.7 percent in the previous month. Increasing bank credit to the commercial sector, which is growing at 28.4 percent, solely backs this rise in money supply growth. But the growth of net foreign exchange assets with the banking sector has dropped from 30.7 percent to 15.4 percent. Due to an expected decline in the foreign exchange reserves, money supply growth is also expected to fall marginally. But it ultimately depends on the stance of RBI's upcoming Mid-term review of monetary policy.

***Forecast:***

*Slowdown in the forex accumulation might restrain from further rise*

*Based on the data up to September 2005, we forecast the growth rate of money supply (M3) for the next three months to be around 15.5 percent.*

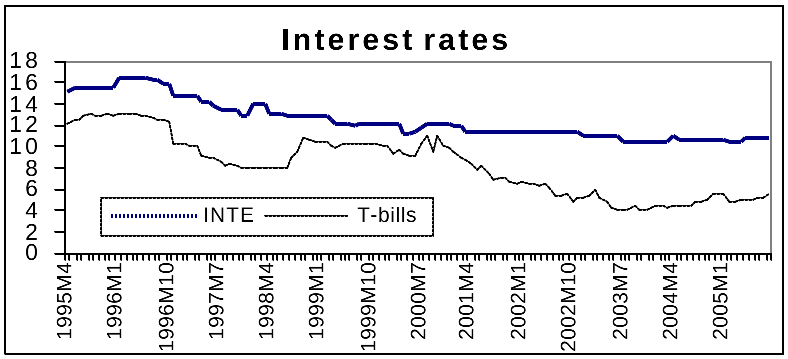


## Interest rates

*Short-term interest rates move upwards.*

Short-term interest rates continue to rise while the lending rates are stable. Although there is a pressure on the interest rates to go up following upward movement in the international interest rates, current expansion in the industrial investments seems to limit the RBI's policy stance in rising interest rates. But the liquidity in the system, growing interest rate differentials (which is expected to restrain the foreign capital inflow), and rising inflation rates could ultimately lead to hike in the interest rates in the coming months.

*Lending rates expected to rise.*




**Forecast:**

*Based on the data up to September 2005, we forecast a marginal rise in both short-term and long-term interest rates in the next three months*

## Exchange rate

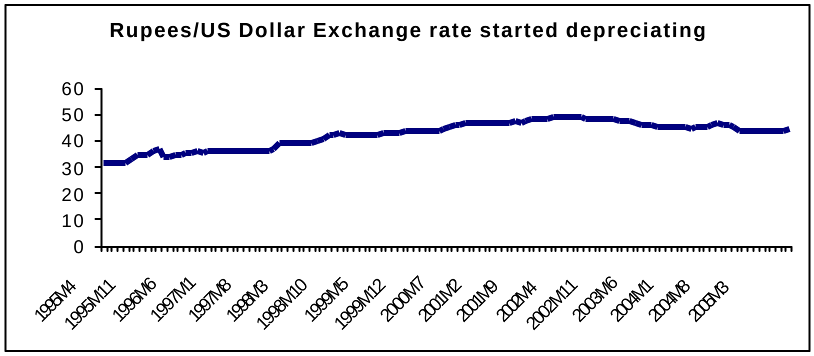
*Rupee/US dollar exchange rate depreciates.*

*Expected to depreciate further*

As we predicted in our August 2005 issue of Monthly Monitor, the Rupee/US dollar exchange rate continued to depreciate and reached to a ten month high of 44.23 by the first week of October 2005. Growing current account deficit, which has stood at a high of US$6.2 billions in this fiscal year's first quarter itself and high World oil prices must have increased the dollar demand. Further, narrowing interest rate differentials, which is expected to constrict dollar supplies, must have also put pressure on the Rupee to weaken. As we expect these factors are going to be there for some time, Rupee is expected to depreciate further in the coming months.

***Forecast:***

***Based on the data up to September 2005, we forecast the Rupee/US Dollar exchange rate to depreciate marginally to 44.5 in the next three months.***



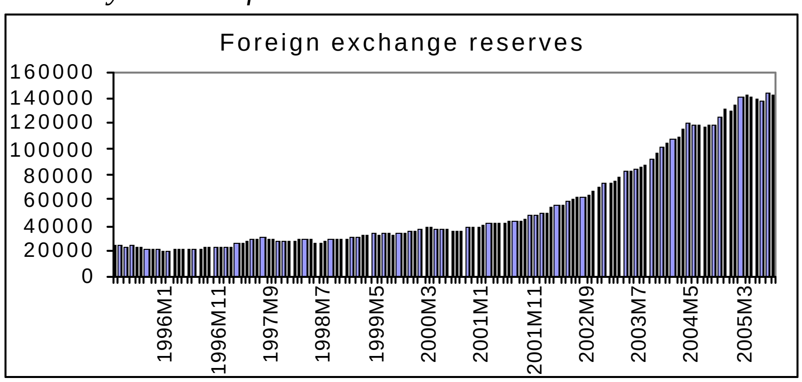

## Foreign Exchange Reserves

*We expect a slowdown in the pace of accumulation of forex reserves.*

The foreign exchange reserves declined slightly to US$143.01 billions by 23rd September 2005. Although the short-term portfolio capital is flowing tremendously into to the stock market, there is a decline in the external commercial borrowings and a sharp decline in the short-term credit, which must have restricted the reserves from further increase. In addition to this rising current account deficit, which is mostly due to high world oil prices, and narrowing interest rate differentials may have also led to this situation. In the next three months also we forecast a marginal fall in the reserves.

***Forecast:***

*Forex reserves are expected to decline marginally to US$ 142 billions by the end of November 2005.*

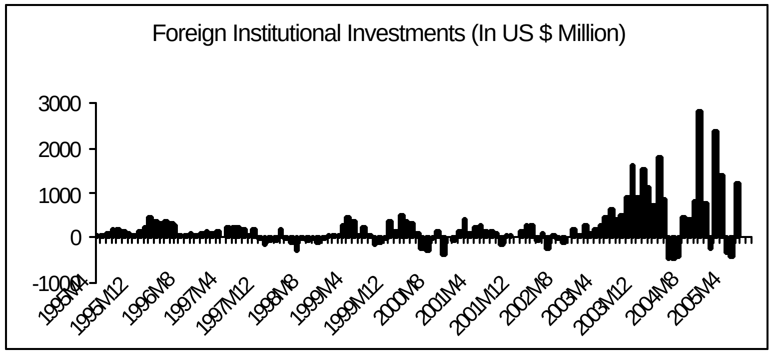



## Foreign Institutional Investment

*FIIs are net buyers in June*

In the month of June 2005, the FII investments have seen a huge net inflow of US$ 1,222 millions. Booming domestic stock market and expected strong growth in the domestic economy, particularly in the industrial sector, have made FIIs net buyers. This phenomenon is also witnessed in most of the emerging markets in Asia. But the future behavior of FIIs depends heavily on the US dollar strength in the international market. As the US interest rates are increasing, the sustenance of current inflow appears doubtful.

*Future behavior depends on RBI's policy stance and other international factors*




## Exports and Imports

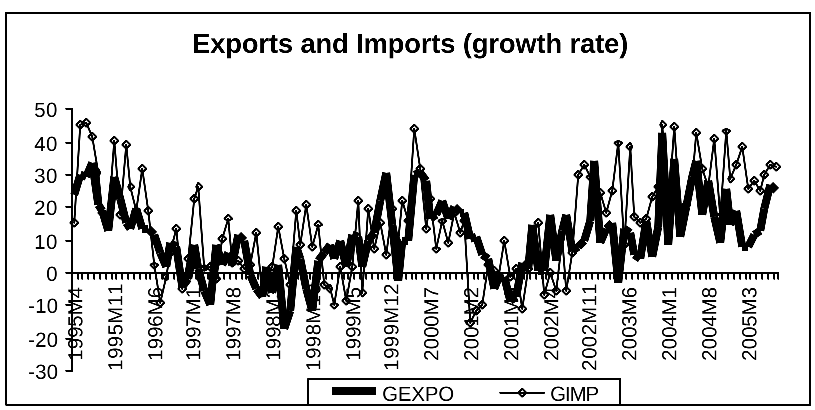
***Double-digit growth in both exports and imports continue.***

***Growing trade deficit is a worrying factor.***

The economy sustains the strong double-digit growth in trade sector for the fifth consecutive months. In August 2005 exports have registered a growth of nearly 25 percent (for April-August 2005 it is 23 percent). This high growth in exports could be due to recovery in the World economy and it also indicates growing competitiveness of India's exports in the international market. On the other hand, imports also grew at a high rate of 32.44 percent in August 2005. While oil imports in April-August 2005 is growing at 37 percent due to high world oil prices, non-oil imports are also growing faster at 37.2 percent thereby reflecting the current boom in the industrial sector. Only worrying factor is that of widening trade deficit, which has already reached to US$17.4 billions. Although the double-digit growth is expected to continue, it could be less than that of last year's growth.

***Forecast:***

*Based on the data up to August 2005, we forecast the average export growth to be 15.2 percent and the average import growth to be 20.6 percent for the next three months.*

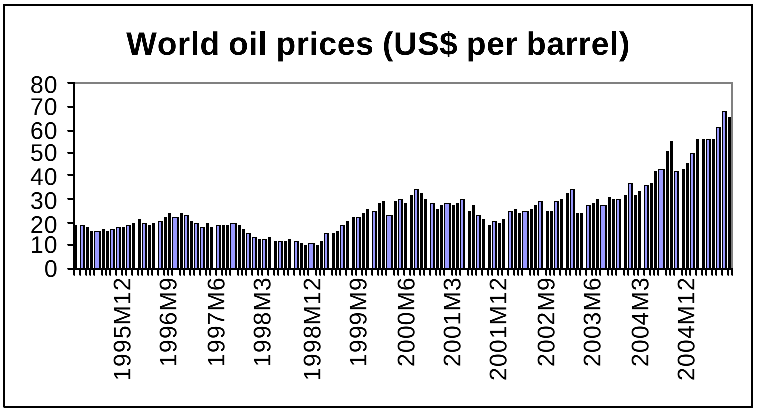


*World oil prices remain volatile.*

*Large permanent component in the high world oil prices needs to be absorbed.*

## Oil Price

The World oil prices remain volatile due to Hurricane Rita effect. But the prices have come down from its peak of US$70 to around US$65 per barrel. Even if the OPEC decides to raise the oil supplies in its forthcoming meeting, the prices might not fall drastically as the current rise is not purely due to supply side factors. It is the growing demand for oil in the international economy that has led to high prices. Hence, it is necessary to fully absorb this high oil prices by the domestic economy rather than postponing.




*Stock market continues to be bullish.*

*Touched its historic high of 8800 in September 2005*

## BSE Sensex

BSE sensex has touched its historic high of 8800 points in September 2005. Backed by the feel-good factor and good corporate results, the stock prices have zoomed to their new heights. Huge surplus liquidity in the system, low interest rate structure and the robust growth in the industrial sector must have led to unprecedented rise in investments into stock market. Further, the FIIs, who were net sellers, have also become bullish recently thereby pushing up the stock prices from the demand side.