MONTHLY MONITOR

Prepared by
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Highlights

Uptrend in Industrial growth continues

The annual growth of Index of Industrial Production for the month of July has come out at 13.8 percent versus 7.1 percent in June 2010, and is largely explained by the 15 percent expansion in manufacturing output. Capital goods grew at a whooping 63 percent. The IIP grew at 11.6 percent in May, 17.6 percent in April and at 13.5 percent in March 2010. 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. The uptrend in industrial activity continues at a fast pace. The recovery has also become more broad-based with 14 out of 17 industry groups recording positive growth during the year 2009-10.

The revised base reduces the inflation rate

Inflation rate stood at 8.51 percent in August as compared to 9.78 percent for the previous month, based on the new series. With the old series it stood at 9.5 percent. The inflation was 10.3 percent in June, 10.6 percent in May and 11 percent in April 2010. The rapid rise of IIP, the slow growth of agriculture and the low base effect explains this double digit inflation in last few months.

Rupee appreciates substantially

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. The rupee was 46.55 per dollar in August, 46.85 in July and 46.56 in June. It is forecasted to remain below 46 for the next three months.

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FII flows are at high US$ 4262.60 million	**The foreign institutional investments (FII) in Indian market were around US$ 4262.60 million in September 2010. The FII was 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 prospects. The expected medium term appreciation of rupee and the prospects of returns increasing further are forming a virtuoso cycle. It is forecasted that the growth in flows is likely to be higher for the next three months.**
Exports rose at 22.5 percent in August	**India's exports after growing at a very high pace in past few months are slowing down, though it grew at a healthy 22.5 percent in August, 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 due to a steep increase non-oil imports on the back of high domestic demand. The imports expanded at 32.2 percent in dollar terms in August 2010.**

IEG FORECAST

Variables	Latest Information available	Forecast for next three months
Inflation rate (WPI)	8.5% in August 2010	7.89%, 7.20%, 6.89%.
Inflation rate (CPI)	9.88% in August 2010	9.82%, 9.76%, 9.70%
Growth rate of IIP	13.8% in July 2010	10.12 %,9.33%, 8.87%
Growth rate of M3	15.2% as on September 10, 2010.	15.70 %, 15.76 %,15.83%
Re/$ exchange rate	46.16 average for September, 2010	45.92, 45.39,45.21
Forex reserves	(US$ 291.60 billion on September24, 2010)	$299.38, $309.36,$316.06
FII inflows (Net)	US$ 4262.60 million in September, 2010	Growth, for next three months, in inflows to be positive.
Growth rate of exports	22.5% for August 2010	19.70%,16.87%,14.63%
Growth rate of imports	32.2% for August 2010	31.98%,30.05%,27.68%

Inflation

The revised base reduces the inflation rate

Inflation rate stood at 8.51 percent in August as compared to 9.78 % for the previous month, based on the new series. With the old series it stood at 9.5 percent. It was 10.3 percent in June, 10.6 percent in May and 11 percent in April 2010. The rapid rise of IIP, the slow growth of agriculture and the low base effect in last few months explains this double digit inflation.

The new WPI index tracks 676 commodities in contrast to the old index which was based on 435 commodities.

The primary articles index with a weight of 20.12 percent was down 0.3 percent in August 2010 over the previous month while the index for fuel, power, light and lubricants with a weight 14.91 percent increased by 0.1 percent, and the index for the major sector, the manufacturing products with a weight of 64.97 percent increased by 0.2 percent.

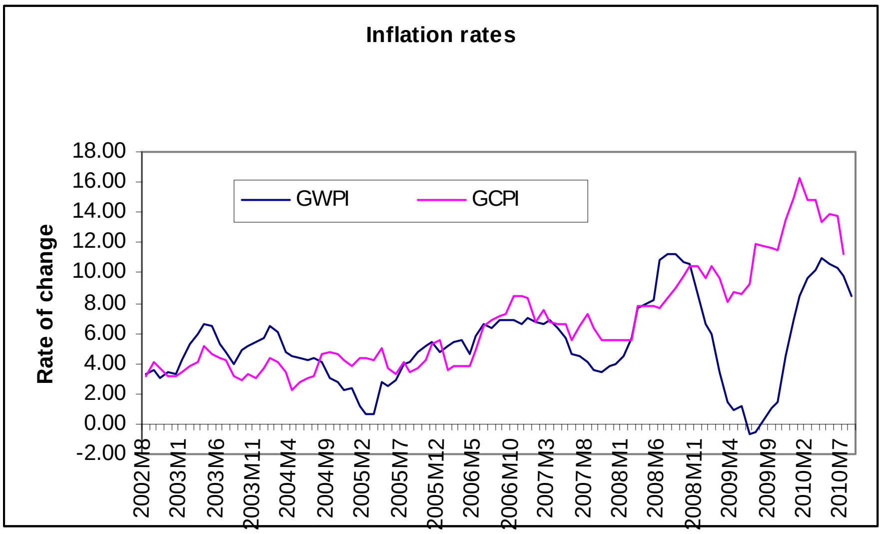
The recent decline in food and fuel prices indicates a marginal cooling down of inflation. Except for the East and the North-East, the rainfall has already been adequate and there is already a perceptible shift towards high value crops which may bring down the inflationary expectations in Food sector. On the other hand, the high GDP growth along with the 27.4 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.

CPI decreases

The annual growth in all India Consumer Price Index Number for Industrial Workers in the month of August 2010 came down to 9.88 percent from 11.25 percent in July 2010. It was 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 weight age given to primary products and food items in CPI, whereas WPI covers a wider range of the outputs of various commodities. It is forecasted, the growth rates in CPI will marginally come down below the double digits for the next three months.

Forecast:

The WPI inflation forecasts are7.89%, 7.20%and 6.89% for, September, October and November 2010, respectively. The CPI inflation forecasts are 9.82%, 9.76%, 9.70% for September, October and November 2010, respectively.



Industrial Production

The high IIP growth at 13.8 percent

The annual growth of Index of Industrial Production for the month of July has come out at 13.8 percent versus 7.1 percent in June 2010, and is largely explained by the 15 percent expansion in manufacturing output. The IIP grew 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.

The uptrend in the industrial activity is getting consolidated. The cumulative growth for the period April-July 2010-11 stands at 11.4% over the corresponding period of the previous 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 July 2010, 12 groups showed positive growth out of 17 groups. 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

Uptrend in Industrial growth continues

growth is likely to hover around 10 to 9 percent in next three months due to the base effect and the expected 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.

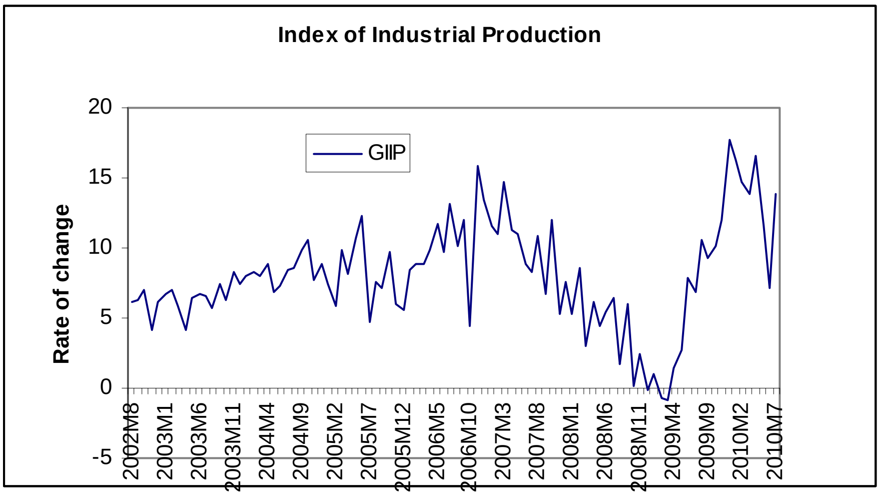
The Mining, Manufacturing and Electricity sectors for the month of June 2010 grew at 9.7 percent, 15 percent and 3.7 percent, respectively, as compared to the same month in the previous year. The mining sector may slow down in the in short run as environmental and tribal rights issues may take time to 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, in Capital goods and in Intermediate goods are 5.1 percent, 63 percent, and 9.1 percent in July 2010. The high 63 percent Capital goods growth is a good sign for sustaining the over all growth rate in the economy.

The Consumer goods grew at 6.7 percent in July 2010 while the Consumer durables grew at 22.1 percent and Consumer non-durables at 0.5 percent.

Forecast:

Based on the available information, we forecast the IIP growth rate for the next three months to be 10.12%, 9.33% and 8.87% for August, September and October 2010, respectively.



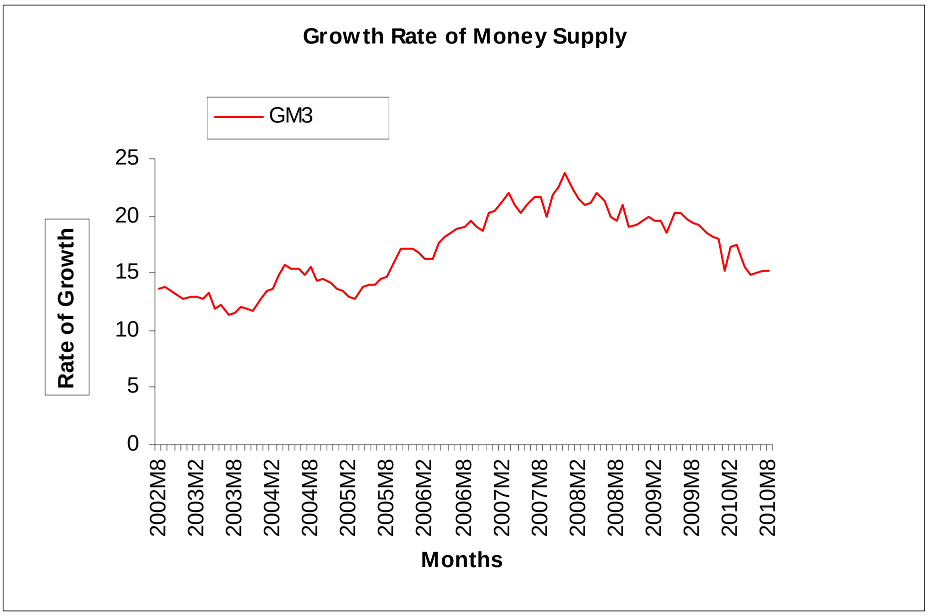
Money and Credit

Money supply at 15.2 percent

As on September 10, 2010, Money supply grew at 15.2 percent as against 20.1 percent in the previous year. It grew at a faster rate of 15. 66 percent in July 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 auctions will slow down the borrowing program of the government this fiscal. The expansion in money supply is likely to be mainly contributed by credit to the commercial sector and increase in net foreign assets. 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 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 15.75 percent for the next three months.

Forecast:

The forecast for the growth rate of money supply (M3) is15.70%, 15.76% and15.83% for October, November and December 2010, respectively.



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 125 basic points since March 2010 to 6 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.

Repo rate at 6 percent

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

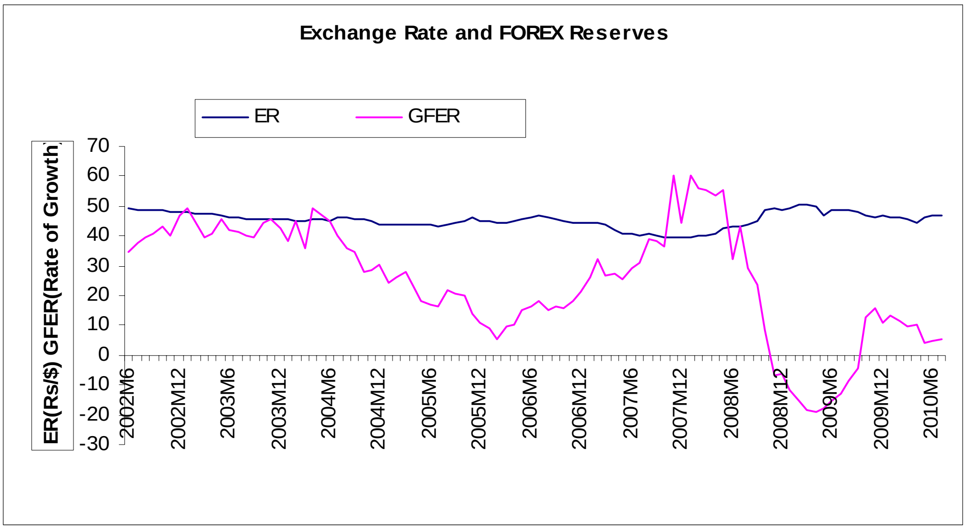
The continuous flow of FIIs into Indian stock market and the strong growth of Indian economy in recent months have assisted in strengthening the Indian rupee. The rupee hit a five month high on the 4th October 2010 at 44.24 rupees per dollar. Rupee appreciated 12.9 percent during the year 2009-10 as 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

Rupee appreciates

substantially	figure of 47.67, mainly due to the drying of flows to the Indian stock market due to the Eurozone crisis. It is forecasted to be below 46 for the current level in the next three months. In the medium run, rupee may appreciate further riding on the expected foreign flows.

Forecast:

In coming months, exchange rate is expected to be around Rs/$45.92, Rs/$45.39 and Rs/$45.21 for October, November and December 2010.



Foreign Exchange Reserves

Foreign exchange reserves stood at US$ 291.60 billion on September 24, 2010. It was 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 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

Foreign Exchange Reserves at healthy US$ 291.60 billions on September 24

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 increase in the next three months.

Forecast:

Forex reserves expected to be $299.38billions, $309.36 billions and $316.06 billions in October, November and December 2010, respectively.

Foreign Institutional Investment

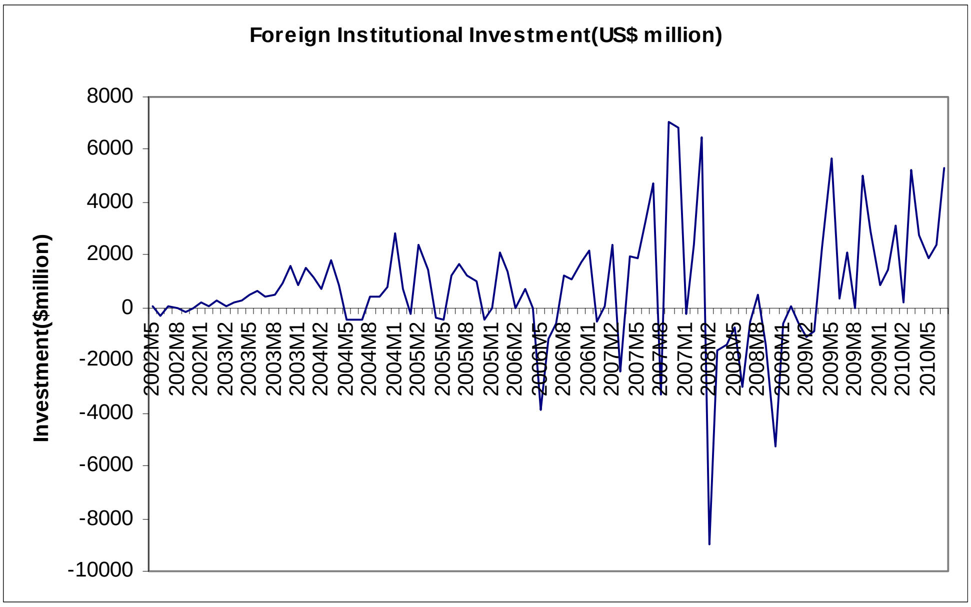
The foreign institutional investments (FII) in Indian market were around US$ 4262.60 million in September 2010. The FII was US$ 3082.75 million in August, US$ 5285.33 million in July and US$2433.99 million in June 2010. These figures clearly show the foreign investors' confidence about India's long term growth prospects. The expected medium term appreciation of rupee and the prospects of returns increasing further are forming a virtuoso cycle. The FII flows was as low as US$ -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 around at a high 20,000 mark recently showing renewed confidence of Indian as well as foreign investors which is 32 months high. 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 higher for the next three months.

FII flows are at high US$ 4262.60 million

Forecast:

Growths in inflows are expected to move in the positive direction for 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 22.5 percent in August2010 at US $ 16.64 billion where as it grew at only13.2 percent at US $ 16.2 billion in July 2010. It grew at an annual 30.4 percent in June, at 35 percent in May and at 36.2 percent in April 2010. The demand has picked up for sectors like cotton yarn, iron ore, gems & jewellery, plastics & linoleum, leather, engineering etc. However, the jump in exports growth can also be attributed to the statistical base effect. This is the eighth consecutive rise after 13 straight months of decline. 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 19.7 per cent in next month. This low forecast, despite the recent stimulus majors by government to increase exports, is mainly due to the not so encouraging global scenario.

Exports rose at 22.5 percent in August

Imports rose at 32.6 percent in August, 2010 at $ 29.7 billion where as it grew at 34.3 percent to US $ 29.8 billion in July, at 23 percent in June and at 38.5 per cent in May 2010. In July 2010, oil imports grew at 12.4 percent over the corresponding period last year, while non-oil imports grew at 41.1 percent. Oil imports in July 2010 grew at only 4.4 percent, in June at 26.5 per cent, in May at 66.7 percent, and in April at 70.5 percent. Non-oil imports grew at 49.6 percent in July 2010, 21.5 per cent in June, 32.3

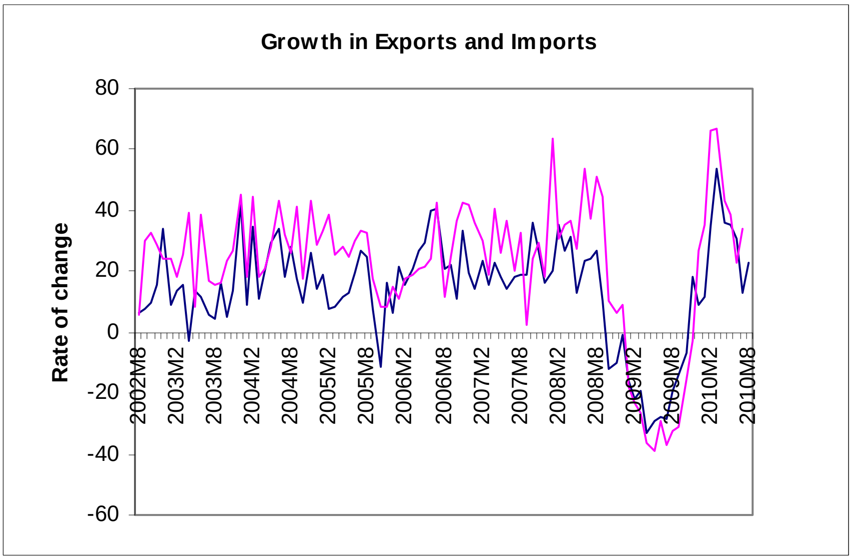
percent in May 2010 and in April at 34.3 percent. The substantive rise in non-oil imports during last few months shows the demand side is picking up due to the rapid recovery process in the domestic economy.

Import growth continues to be high at 32.2%

The trade deficit widened to US$13.06 billion in August, 2010 from US$12.9 billion in July, and from US$10.6 billion in June. The deficit was 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. The August's deficit is highest since September 2008. The imports are forecasted to increase at more than 50 percent of the rate of exports resulting in a higher deficit.

Forecast:

Exports growths are forecasted as 19.70%,16.87% and14.63% for September, October and November 2010 respectively. Imports are expected to increase by 31.98%,30.05% and 27.68% for September , October and November 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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