



Confederation of Indian Industry

CII Southern Region

Industry and Economic Update

State of the Indian Economy

October-December 2009

TABLE OF CONTENTS

REAL GDP GROWTH	3
REAL GDP GROWTH IN Q2FY2010 HIGHEST FOR SIX QUARTERS	3
AGRICULTURAL PRODUCTION	6
SHARP SLOWDOWN IN AGRICULTURAL PRODUCTION IN 2008-09.....	6
SOUTH-WEST MONSOON RAINFALL, 2009 AT 77% OF NORMAL IN 2009	7
EXPECTED DECLINE IN KHARIF FOOD GRAINS PRODUCTION DURING 2009-10.....	10
INDUSTRIAL PRODUCTION	12
RECENT MODERATE RECOVERY IN GLOBAL INDUSTRIAL PRODUCTION	12
SHARP CONTRACTION IN DOMESTIC INDUSTRIAL PRODUCTION SINCE LATE-2008, RECOVERY FROM MID-2009	13
INVESTMENT INFLOWS	15
CREDIT CONDITIONS	18
CONTINUED SLOWDOWN IN CREDIT GROWTH	18
SOUTHERN REGION GROWTH IN CREDIT AND DEPOSITS.....	20
SHORT-TERM WORLD FINANCIAL OUTLOOK.....	21
INFLATIONARY CONDITIONS	22
SHARP DECLINE IN GLOBAL PRICES AND INFLATION SINCE LATE-2008	22
SHORT-TERM OUTLOOK.....	24
RECENT INCREASE IN DOMESTIC HEADLINE INFLATION; CONSUMER PRICE INFLATION REMAINS HIGH.....	24
TRADE TRENDS	27
SHARP CONTRACTION IN WORLD TRADE SINCE LATE-2008, BUT RECENT STABILISATION.....	27
EXPECTED RECOVERY IN WORLD OUTPUT AND TRADE GROWTH IN 2010	29
EXCHANGE RATE TRENDS	30
SHARP CONTRACTION IN INDIA'S TRADE SINCE SEPTEMBER 2008	31
COMMODITY-WISE EXPORT TRENDS.....	35
BALANCE OF PAYMENTS TRENDS.....	35
BOP TRENDS FOR Q1FY2010.....	35
SHORT-TERM ECONOMIC OUTLOOK	39
GLOBAL SHORT-TERM OUTLOOK.....	39
DOMESTIC OUTLOOK.....	41

REAL GDP GROWTH

Real GDP Growth in Q2FY2010 Highest for Six Quarters

The Indian economy had exhibited signs of a slowdown during FY2009¹ and Q1FY2010, with real growth in gross domestic product (GDP) decelerating sharply from 7.8% in Q1FY2009 to 5.8% in Q3FY2009, and 5.8% in Q4FY2009.

Real GDP and Growth

	FY2009				FY2010	
	Q1	Q2	Q3	Q4	Q1	Q2
Rs. Billion						
Agriculture, forestry and fishing	1,318	1,052	1,812	1,478	1,350	1,061
Agriculture	1,318	1,052	1,812	1,478	1,350	1,061
Mining & Quarrying	149	143	167	183	161	157
Manufacturing	1,193	1,214	1,214	1,256	1,234	1,325
Electricity, gas & water supply	164	164	165	167	174	176
Industry	1,506	1,521	1,546	1,606	1,569	1,658
Construction	586	601	601	638	627	640
Trade, hotels, transport & communication	2,239	2,271	2,385	2,651	2,420	2,465
Financing, insurance, real estate & bus. Services	1,169	1,187	1,251	1,326	1,263	1,278
Community, social & personal services	1,008	1,106	1,205	1,330	1,077	1,246
Services	5,001	5,166	5,442	5,946	5,387	5,629
GDP at Factor Cost	7,826	7,739	8,800	9,029	8,306	8,348
Yoy Growth						
Agriculture, forestry and fishing	3.0%	2.7%	-0.8%	2.7%	2.4%	0.9%
Agriculture	3.0%	2.7%	-0.8%	2.7%	2.4%	0.9%
Mining & Quarrying	4.6%	3.7%	4.9%	1.6%	7.9%	9.5%
Manufacturing	5.5%	5.1%	0.9%	-1.4%	3.4%	9.2%
Electricity, gas & water supply	2.7%	3.8%	3.5%	3.6%	6.2%	7.4%
Industry	5.1%	4.8%	1.6%	-0.5%	4.2%	9.0%
Construction	8.4%	9.6%	4.2%	6.8%	7.1%	6.5%
Trade, hotels, transport & communication	13.0%	12.1%	5.9%	6.3%	8.1%	8.5%
Financing, insurance, real estate & bus. Services	6.9%	6.4%	8.3%	9.5%	8.1%	7.7%
Community, social & personal services	8.2%	9.0%	22.5%	12.5%	6.8%	12.7%
Services	10.0%	9.8%	9.5%	8.4%	7.7%	9.0%
GDP at Factor Cost	7.8%	7.7%	5.8%	5.8%	6.1%	7.9%

Source: Central Statistical Organisation (CSO), ImaCS Analysis

¹ Throughout the document, FY means Fiscal year from April-March. Thus, FY2009 and/or 2008-09 means the period April 2008-March 2009. Statement of year, e.g. 2009 and so on, without a prefix FY means calendar year from January-December. Thus, 2009 or CY2009 means period January-December 2009, and so on. Throughout the document, Q1FY (year) means quarter April-June; and so on. By comparison, 1Q (year) means quarter January-March. Thus, Q1FY2010 means April-June 2009, and so on. 1Q2009 means January-March 2009, and so on. H1FY (year) means period April-September, e.g. H1FY2009 means April-September 2008, and so on. 1H (year) means January-June, e.g. 1H2009 means January-June 2009, and so on.

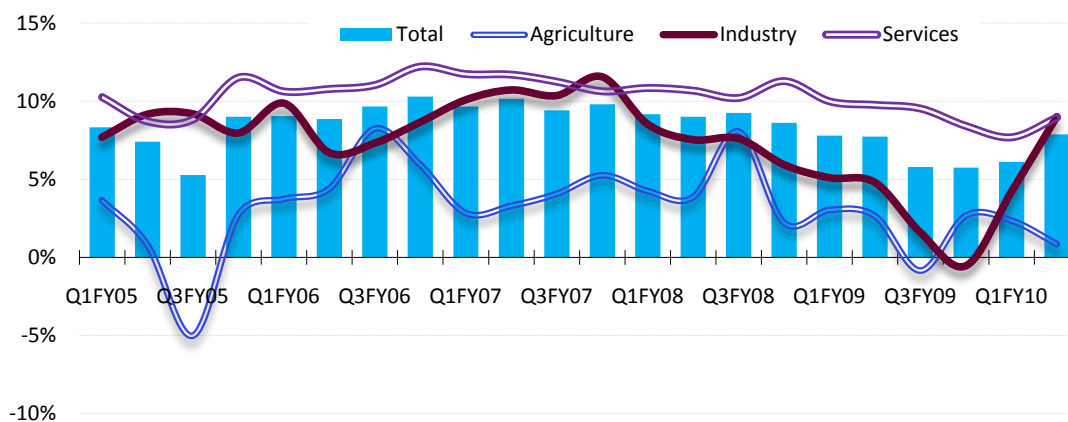
However, as can be seen from the table above, real GDP growth improved marginally in Q1FY2010 followed by a strong recovery in Q2FY2010, when real GDP increased 7.9% (yoy), representing the highest quarterly growth rate since Q4FY2008. GDP increased 7% (yoy) during H1FY2010, compared with 7.9% (yoy) in H1FY2009. However, real GDP growth in H1FY2010 represents a sharp improvement from growth of 5.8% in H2FY2009.

The significant recovery in Q2FY010 has been driven by the following factors:

- ❑ Sharp recovery in GDP from industry from -1.4% in Q4FY2009 to 3.4% in Q1FY2010, and 9.2% in Q2FY2010, caused by higher growth in nearly all sub-segments. Real GDP growth from industry in Q2FY2010 represented the highest quarterly growth since Q1FY2008.
- ❑ Although services sector real GDP growth increased from 7.7% in Q1FY2010 to 9% in Q2FY2010, it still represents moderation from the high growth phase from Q4FY2005 to Q1FY2009, when quarterly growth exceeded 10%. Services sector growth has moderated primarily because of lower growth in three segments—`construction`, `financing, insurance, real estate & business services`; and `community, social & personal services` which offset moderate recovery in `construction; and `trade, hotels, transport & communication.
- ❑ Further, agricultural output growth continued to weak and is likely to remain so in FY2010 because of the output impact of deficient monsoon.

Quarterly Growth in GDP

Percent, at constant prices

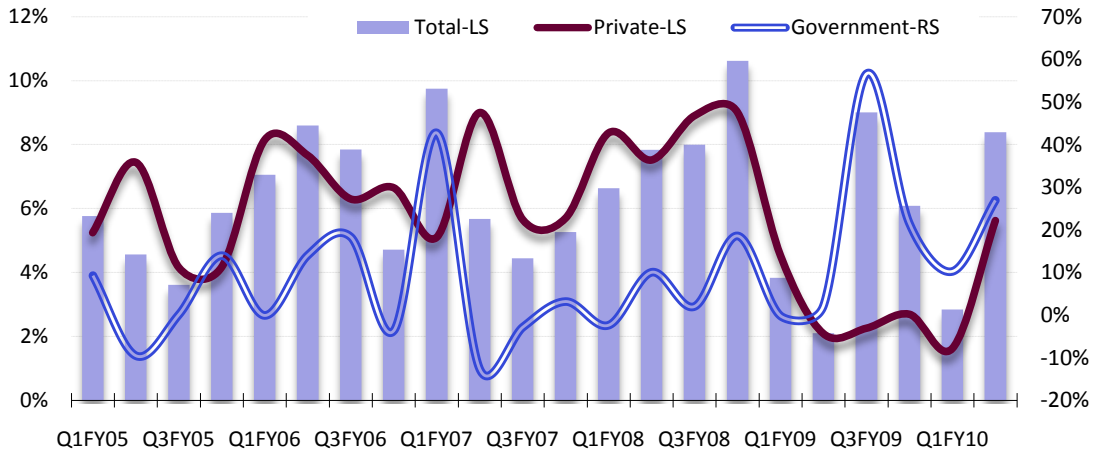


Source: CSO, IMAcS Analysis

Yoy growth in private final consumption expenditure (PFCE) has declined from 9% in Q4FY2008 to 2.7% in Q4FY2009, and to only 1.6% in Q1FY2010. PFCE increased 5.6% (yoy) in Q2FY2010 indicating a recovery in consumer confidence and domestic demand. However, total final consumption has declined at a lower rate primarily because of a sharp increase in government consumption expenditure from the latter half of FY2009. Although growth in total final consumption expenditure had declined to 2.8% in Q1FY2010 because of sharply lower growth in government expenditure in Q1FY2010; it recovered to 8.4% in Q2FY2010 because of a 26.9% increase in government expenditure.

Yoy Growth in Consumption Expenditure

Percent, at constant prices



Source: CSO, IMaCS Analysis

As can be seen from the table below, manufacturing accounted for 18.3% of incremental real GDP growth in Q2FY2010, which represents a recovery from -3.5% in Q4FY2009. This represents an increase from the recent peak of 16.8% in Q1FY2008. Other sectors that have accounted for higher share of incremental GDP growth in Q2FY2010 vis-a-vis Q1FY2010 include 'community, social, and personal services'.

Incremental GDP and Share

	FY2009				FY2010	
	Q1	Q2	Q3	Q4	Q1	Q2
Rs. Billion (yoy)						
Agriculture, forestry and fishing	38.89	27.18	-15.41	38.57	31.19	9.02
Agriculture	38.89	27.18	-15.41	38.57	31.19	9.02
Mining & Quarrying	6.58	5.11	7.87	2.90	11.78	13.67
Manufacturing	62.21	58.62	10.85	-17.32	41.16	111.31
Electricity, gas & water supply	4.37	5.96	5.58	5.77	10.12	12.20
Industry	73.16	69.69	24.30	-8.65	63.06	137.18
Construction	45.55	52.45	24.02	40.48	41.59	38.82
Trade, hotels, transport & communication	256.94	245.06	132.37	157.53	180.99	193.24
Financing, insurance, real estate & bus. Services	75.62	71.05	95.83	115.22	94.20	91.05
Community, social & personal services	76.17	90.98	221.31	148.24	68.36	140.00
Services	454.28	459.54	473.53	461.47	385.14	463.11
Incremental GDP at Factor Cost	566.34	556.40	482.43	491.39	479.37	609.30
Share						
Agriculture, forestry and fishing	6.9%	4.9%	-3.2%	7.8%	6.5%	1.5%
Agriculture	6.9%	4.9%	-3.2%	7.8%	6.5%	1.5%
Mining & Quarrying	1.2%	0.9%	1.6%	0.6%	2.5%	2.2%
Manufacturing	11.0%	10.5%	2.2%	-3.5%	8.6%	18.3%
Electricity, gas & water supply	0.8%	1.1%	1.2%	1.2%	2.1%	2.0%
Industry	12.9%	12.5%	5.0%	-1.8%	13.2%	22.5%
Construction	8.0%	9.4%	5.0%	8.2%	8.7%	6.4%
Trade, hotels, transport & communication	45.4%	44.0%	27.4%	32.1%	37.8%	31.7%
Financing, insurance, real estate & bus. Services	13.4%	12.8%	19.9%	23.4%	19.7%	14.9%
Community, social & personal services	13.4%	16.4%	45.9%	30.2%	14.3%	23.0%
Services	80.2%	82.6%	98.2%	93.9%	80.3%	76.0%
GDP at Factor Cost	100%	100%	100%	100%	100%	100%

Source: CSO, IMAcS Analysis

AGRICULTURAL PRODUCTION

Sharp Slowdown in Agricultural Production in 2008-09

The Ministry of Agriculture had set the target for food grains production for FY2009 at 233 million tonnes (mt), compared with actual achievement of 230.8 mt in 2007-08. However, as per Fourth Advance Estimates released on July 21, 2009, total food grains production during 2008-09 increased 1.3% or 3.1 mt in 2008-09 to 233.9 mt. The increase in food grains production during 2008-09 is despite the 2.7% decline in kharif food grains production attributable to the crop losses due to floods in States like Bihar, Eastern UP, Orissa and Assam during the kharif season 2008-09. However, rabi food grain production growth has improved from 2.9% in 2007-08 to 5.8% in 2008-09 because of higher production of cereals. The higher growth in rabi production more than compensated for the loss in kharif output. The slowdown in wheat production during 2008-09 reflected the unusually warm weather in January and early February 2009. Amongst other crops, there has been a decline in the production of oilseeds, cotton, jute, mesta, and sugarcane.

Agricultural Production

	Mt			Growth		
	2007	2008	2009	2007	2008	2009
Rice	93.36	96.69	99.15	1.7%	3.6%	2.5%
Wheat	75.81	78.57	80.58	9.3%	3.6%	2.6%
Coarse Cereals	33.92	40.75	39.48	-0.4%	20.1%	-3.1%
Pulses	14.20	14.76	14.66	6.3%	4.0%	-0.7%
Total Food grains	217.28	230.78	233.87	4.2%	6.2%	1.3%
<i>Of which Kharif</i>	<i>110.58</i>	<i>120.96</i>	<i>117.70</i>	<i>0.6%</i>	<i>9.4%</i>	<i>-2.7%</i>
<i>Rabi</i>	<i>106.71</i>	<i>109.82</i>	<i>116.17</i>	<i>8.1%</i>	<i>2.9%</i>	<i>5.8%</i>
Total Nine Oilseeds	24.29	29.76	28.16	-13.2%	22.5%	-5.4%
Cotton	3.85	4.40	3.94	22.3%	14.4%	-10.5%
Jute & Mesta	2.03	2.02	1.87	4.1%	-0.6%	-7.2%
Sugarcane	355.52	348.19	273.93	26.4%	-2.1%	-21.3%

Source: Ministry of Agriculture, ImaCS Analysis

South-West Monsoon Rainfall, 2009 at 77% of Normal in 2009

The India Meteorological Department (IMD) issues operational long range forecasts for the southwest monsoon rainfall in two stages. The first stage forecast is issued in April and the second stage forecast is issued in June. During 2009, the first stage forecast for the southwest monsoon rainfall over the country was issued on April 17, 2009. According to this forecast, the long range forecast for the 2009 southwest monsoon season (June to September) was that the rainfall for the country as a whole was likely to be Near Normal. Quantitatively, monsoon season rainfall was likely to be 96% of the long period average (LPA) with a model error of $\pm 5\%$. On June 24, 2009, the IMD issued its second stage forecast. According to this forecast, the long range forecast update for the 2009 south-west monsoon season (June to September) was revised downwards to 93% of LPA with a model error of $\pm 4\%$. However because of the deficient rainfall situation, inputs from statistical and numerical weather prediction (NWP) models based on latest data, the IMD issued its third forecast on August 2009. According to this forecast, the long range forecast for the 2009 southwest monsoon season (June to September) was likely to be 87% of the LPA with a model error of $\pm 4\%$.

The lower forecast was primarily because of the prevalence of El Nino-Southern Oscillation (ENSO) neutral conditions. It should be noted that there is a characteristic change in the ENSO-associated extremes with the onset of the summer monsoon in June; El Nino is associated with lower frequency of warm extremes during the pre-monsoon months and with higher frequency of warm extremes during the monsoon and post-monsoon season. The opposite features are seen in the case of La Nina. In addition, El Nino leads to an increase in extreme highest temperature, whereas La Nina leads to a decrease, during monsoon and post-monsoon months.

During the South-West Monsoon Season, 2009; after a hiatus of about two weeks or more mainly over parts of central & east India, southwest monsoon advanced over the remaining parts of Gujarat, MP, Chhattisgarh, Orissa, WB & Sikkim and entire Bihar, Jharkhand, east UP, and Uttarakhand on June 29, 2009. Subsequently, monsoon advanced over many parts of northwest India on June 30, 2009, and remaining parts of northwest India on July 1, 2009 and July 3, 2009. Thus, southwest monsoon covered the entire country about 12 days earlier than its normal schedule.

State of the Economy

Recent estimates indicate that the northward propagation of the first episode of intra-seasonal oscillation (ISO) associated with the onset phase of the Indian summer monsoon (ISM) has slowed down significantly during the past decade compared with prior decades. Estimates indicate that the average propagation speed across the continent has reduced from approximately 2° latitude per day during 1960-83 to about 1° latitude per day during 1984-2007. The slowdown is due to systematic weakening of two regional climatic features responsible for northward progression of the tropical convergence zone (TCZ) namely, the vertical easterly wind shear and the north-south gradient of the mean low-level humidity around the equator. Eastward shift of the Walker circulation associated with increasing strength of El Ninos appears to be responsible for weakening of the vertical wind shear over Indian monsoon region.

The cumulative seasonal rainfall for the country as a whole during this year's monsoon has been 23% below normal. Out of 526 meteorological districts for which data are available, 215 districts (41%) of the meteorological districts received excess/normal rainfall and the remaining 311 districts (59%) received deficient/scanty rainfall during the season. Out of 36 meteorological sub-divisions, rainfall was excess/normal in 13, and deficient/scanty in 23 meteorological sub-divisions. The Comparative details of the rainfall distribution for the country as a whole and over the four broad homogeneous regions of India are given below:

Rainfall Situation during South-West Monsoon, 2009

	Rainfall (mm)			Percent Departure from	
	Normal	Actual (2008)	Actual (2009)	Normal	2008
Country as a whole	892.5	873.2	689.9	-22.7%	-21.0%
Northwest India	611.7	651.7	392.1	-35.9%	-39.8%
Central India	995.1	956.9	795.4	-20.1%	-16.9%
South Peninsula	722.5	692.5	692.9	-4.1%	0.1%
North East India	1,427.3	1,346.0	1,037.7	-27.3%	-22.9%

Source: IMD

Monthly rainfall was 53% of LPA in June, 96% of LPA in July, 73% of LPA in August and 79% of LPA in September. As can be seen from the table below, although rainfall has been 23% below normal, the deficit has been reduced since August 2009.

Week By Week Progress of Cumulative Seasonal Rainfall

Percent below normal (-)/above normal (+)

	Country as a whole	North-west India	Central India	South Peninsula	North East India
03.06.09	-32	-40	-50	-14	-32
10.06.09	-39	-31	-56	-15	-44
17.06.09	-45	-26	-72	-21	-46
24.06.09	-54	-49	-73	-38	-55
01.07.09	-46	-45	-59	-31	-41
08.07.09	-36	-50	-40	-18	-34
15.07.09	-27	-43	-15	-12	-40
22.07.09	-19	-38	3	-6	-43
29.07.09	-19	-33	1	-15	-39
05.08.09	-25	-40	-13	-18	-36
12.08.09	-29	-43	-19	-23	-36
19.08.09	-26	-37	-22	-20	-27
26.08.09	-25	-40	-20	-14	-25
02.09.09	-23	-39	-17	-11	-26
09.09.09	-20	-34	-15	-8	-23
16.09.09	-21	-32	-17	-8	-26
23.09.09	-22	-34	-19	-8	-25
30.09.09	-23	-36	-20	-4	-27

Source: IMD, Ministry of Earth Sciences

In the Southern region, rainfall data for the South West Monsoon indicates significant deficits in coastal AP and Telangana. By comparison, as can be seen from the table below, monsoon rainfall has been normal (+19% to -19%) in most of the regions, and excess in North Interior Karnataka and South Interior Karnataka.

Rainfall Situation in The Southern Region during Monsoons

	Rainfall (mm)			Percent Departure from	
	Normal	Actual (2008)	Actual (2009)	Normal	2008
Country as a whole	892.5	873.2	689.9	-22.7%	-21.0%
South Peninsula	722.5	692.5	692.9	-4.1%	0.1%
Coastal Andhra Pradesh	575.2	599.0	429.6	-25.3%	-28.3%
Telangana	767.3	797.5	497.9	-35.1%	-37.6%
Rayalaseema	380.9	387.6	390.1	2.4%	0.6%
Tamil Nadu & Pondicherry	315.6	324.4	314.8	-0.3%	-3.0%
Coastal Karnataka	3,173.9	2,663.3	3,469.1	9.3%	30.3%
North Interior Karnataka	490.9	430.6	601.3	22.5%	39.6%
South Interior Karnataka	659.3	720.8	855.3	29.7%	18.7%
Kerala	2,143.0	1,678.5	1,959.4	-8.6%	16.7%
Lakshadweep	985.2	933.9	1,026.4	4.2%	9.9%

Source: IMD

Expected Decline in Kharif Food Grains Production during 2009-10

The performance of the South-West monsoon 2009, with a shortfall of 23% in precipitation, is the weakest since 1972. The food grains production weighted index (PRN), constructed by the Reserve Bank of India (RBI) indicates a deficiency of 27%. The deficient South-West monsoon has impacted the kharif sowing, which is about 5.3% below that of the last year. Latest sowing position indicates that sowing of all crops during the current kharif season as on October 22, 2009 was 90% of the normal level. Sowing of most pulses and cotton are higher than last year levels, while the sowing of coarse cereals and jute remained the same as last year, though paddy sowing has been substantially affected (15.7% below last year's level). Other crops whose sowing has been affected somewhat include oilseeds and sugarcane.

Area Coverage under Kharif and Rabi Summer Crops

Thousand hectares, Up to October 22, 2009

	2008	2009	Change
Paddy	38,919	32,817	-15.7%
Jowar	2,934	3,127	6.6%
Bajra	8,527	8,544	0.2%
Maize	7,053	7,113	0.9%
Total Coarse cereals	20,668	20,738	0.3%
Arhar	3,447	3,592	4.2%
Urad	2,090	2,240	7.2%
Moong	2,235	2,401	7.4%
Total Pulses	9,599	10,142	5.7%
Groundnut	5,333	4,447	-16.6%
Soyabean	9,635	9,611	-0.2%
Total Oilseeds	18,443	17,491	-5.2%
Rapeseed & mustard	980	863	-11.9%
Sunflower	240	234	-2.5%
Total Rabi/Summer oilseeds	1,342	1,208	-10.0%

Considering that kharif paddy is an important crop accounting for about 86% of total rice production and 36% of total food grains production in India, the shortfall in its sowing could be expected to depress the overall food grains production during 2009-10. As a result, kharif 2009-10 and total agricultural production is expected to be substantially lower, particularly for paddy and oilseeds, in view of lower yields and acreage consequent on lower precipitation in the current year.

As per First Advance Estimates for 2009-10 released on November 3, 2009, total kharif food grains production during 2009-10 is expected to decline 17.9% (or by 21.1 mt) to 96.63 mt. This represents the lowest kharif food grains production since output was affected during 2002-03, when kharif food grains production declined 22.2%. Except for cotton, all kharif crops have experienced moderate to severe decline.

Kharif Agricultural Production

	Mt			Growth		
	2008	2009	2010	2008	2009	2010
Rice	82.66	84.58	69.45	3.1%	2.3%	-17.9%
Coarse Cereals	31.89	28.34	22.76	24.5%	-11.1%	-19.7%
Pulses	6.40	4.78	4.42	33.5%	-25.3%	-7.5%
Food grains	120.96	117.70	96.63	9.4%	-2.7%	-17.9%
Oilseeds	20.71	17.88	15.23	47.8%	-13.7%	-14.8%
Cotton	4.40	3.94	4.02	14.4%	-10.5%	2.2%
Jute & Mesta	2.02	1.87	1.84	-0.6%	-7.2%	-1.6%
Sugarcane	348.19	273.93	249.48	-2.1%	-21.3%	-8.9%

Source: Ministry of Agriculture, IMaCS Analysis

However, prospects for rabi 2009-10 crop remain promising on account of delayed withdrawal of South-West monsoon, the strong and large 'allied sector' and the various Government policies supporting rural sector. The progress of the North-East monsoon too will have a bearing on overall agricultural output for 2009-10. According to IMD, during the Post Monsoon Season (October-December) cumulative rainfall for the period October 1, 2009 to December 9, 2009 was 11% above normal. The spatial distribution of rainfall reveals that of the 36 meteorological sub-divisions, cumulative rainfall was excess/normal in 24 subdivisions.

Rainfall Situation for the Post-Monsoon Season Rainfall (October-December)

October 1 to December 9

	Rainfall (mm)		Percent Departure from Normal
	Normal	Actual	
Country as a whole	112.8	125.6	11.3%
Northwest India	43.8	45.7	4.3%
Central India	75.8	115.4	52.2%
South Peninsula	252.0	265.3	5.3%
North East India	152.1	128.6	-15.5%
South Peninsula	252.0	265.3	5.3%
Coastal Andhra Pradesh	311.2	248.8	-20.1%
Telangana	106.9	126.2	18.1%
Rayalaseema	201.3	193.0	-4.1%
Tamil Nadu & Pondicherry	389.3	398.1	2.3%
Coastal Karnataka	250.1	409.2	63.6%
North Interior Karnataka	132.6	269.6	103.3%
South Interior Karnataka	193.3	178.3	-7.8%
Kerala	479.4	499.5	4.2%
Lakshadweep	297.4	291.0	-2.2%

Source: IMD

Data on progress of rabi sowing till December 17, 2009 indicate higher sowing for wheat, rice, and pulses; but declines for coarse cereals and oilseeds.

State of the Economy

Area Coverage under Rabi Crops

Thousand hectares, Up to December 17, 2009

	2008	2009	Change
Wheat	22,601	23,132	2.3%
Rice	273	399	46.2%
Coarse Cereals	6,330	5,919	-6.5%
Pulses	11,260	11,790	4.7%
Oilseeds	8,516	8,135	-4.5%

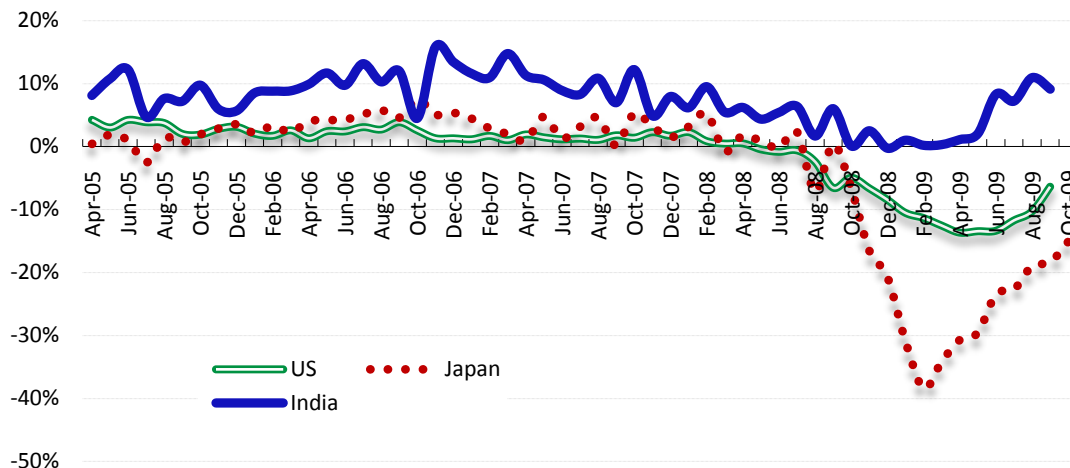
INDUSTRIAL PRODUCTION

Recent Moderate Recovery in Global Industrial Production

Following the financial crisis in September 2008, world industrial production, trade, and employment had dropped sharply. The sharp contraction was due to the severe credit crunch, sharp fall in equity markets, continuing deflation of housing bubbles, and a sharp erosion of household wealth. Industrial production and merchandise trade plummeted in the fourth quarter of 2008 and continued to fall rapidly in early 2009 across both advanced and emerging economies, as purchases of investment goods and consumer durables were hit by credit disruptions and rising anxiety and inventories started to build rapidly. Activity in emerging and Asian economies with heavy reliance on manufacturing exports has fallen sharply, although the downturns in China and India have been somewhat muted given the lower shares of their export sectors in domestic production and more resilient domestic demand.

Recent data provide some indications that the rate of contraction may now be starting to moderate. The situation of sharp inventory adjustment and consequent decline in industrial production has eased to the extent that inventory changes may no longer be a drag on growth and could add to it in the near term. Similarly, global trade reached a trough in 1Q2009 and is poised to accelerate as the economic recovery gathers strength and broadens in scope. In the large emerging-market economies, which were not directly concerned by the meltdown in financial markets, the recovery in economic activity that began earlier this year is gaining momentum. Business confidence has picked up modestly. In the US, industrial production has rebounded and real GDP has grown caused by slower destocking and the Car Allowance Rebate System (CARS), also known as 'Cash for Clunkers' that led to a sharp increase in new automobile sales in July-August 2009. Recent increases in share prices have helped rebuild a fraction of the lost household wealth, and prices in the housing market appear to have stabilised. However, unemployment has continued to rise. Although destocking is expected to continue in 2009, the rate should decline, thereby boosting growth. After a recent increase, The Purchasing Manager's Index (PMI) of the Institute of Supply Management (ISM) declined to 53.6% in November 2009, compared with 55.7% in October 2009, 48.9% in August 2009, and a low of 32.9% in December 2008. A reading above 50% indicates that the manufacturing economy is generally expanding; below 50% indicates that it is generally contracting. ISM's New Orders Index registered 60.3% in November 2009, 1.8 percentage points higher than the 58.5% registered in October 2009. This is the fifth consecutive month of growth in the New Orders Index. A New Orders Index above 48.8%, over time, is generally consistent with an increase in the Census Bureau's series on manufacturing orders (in constant 2000 dollars).

Yoy Growth in Industrial Production

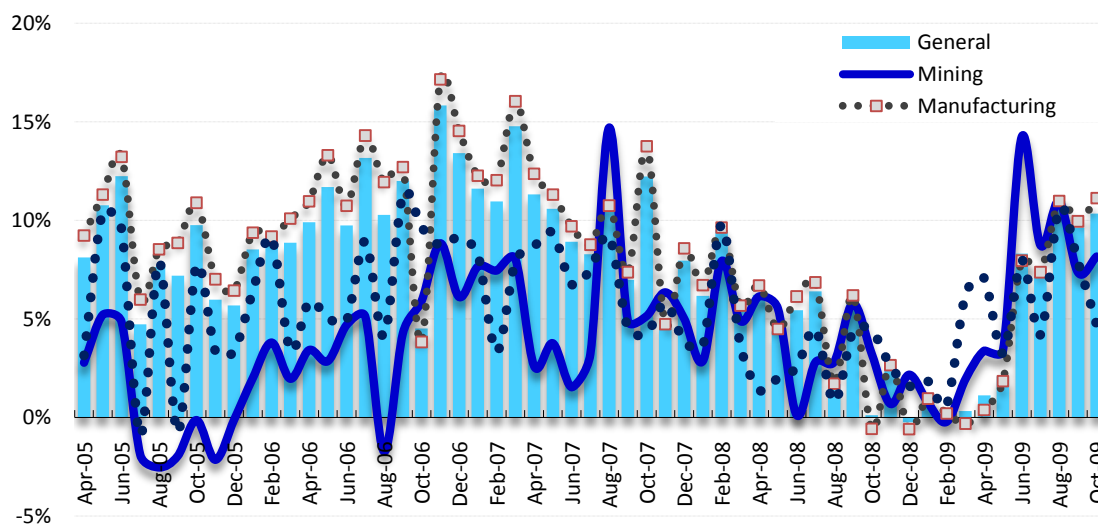


Source: IMF, IMAcS Analysis

Sharp Contraction in Domestic Industrial Production since late-2008, Recovery from mid-2009

In recent years, India’s industrial production growth, as measured by the Index of Industrial Production (IIP) had peaked in 2007, but had subsequently shown signs of slowdown because of a slowdown in manufacturing activity. However, industrial production contracted sharply since September 2008. The intra-year movement of growth in industrial production reveals that the IIP, which had already declined from 10% in 5MFY2008 to 4.9% in 5MFY2009, slipped to 1.7% in August 2008, before recovering to 6% in September 2008. The IIP growth, however, decelerated thereafter with <1% (yoy) growth in most of the subsequent months during Q4FY2009. Before this, IIP had registered negative growth in April 1994.

Domestic Yoy Growth in Industrial Production



Source: Central Statistical Organisation (CSO), IMAcS Analysis

State of the Economy

Although the IIP growth slowed down sharply in FY2009, the IIP posted positive growth of 1.1% in April 2009, which subsequently accelerated. However, growth moderated to 7.2% in July 2009, before increasing significantly to 9-11% during August-October 2009. The higher growth is attributable to the base effect as IIP growth had started to plunge during Q2FY2010. Overall, the IIP increased 9.2% (yoy) in Q2FY2010, compared with 3.8% (yoy) in Q1FY2010. The growth in FY2010 was primarily because of strong growth in the production of 'rubber, plastic, petroleum products', 'textile products', 'wool, silk and man-made fibre textiles', 'wood and wood products', 'machinery and equipment other than transport equipment', 'non-metallic mineral products', 'basic metal and alloy industries', 'leather and leather fur products' and 'other manufacturing industries'.

Growth of Manufacturing Groups (2-digit)

Yoy percent

	Q3 FY2009	Q4 FY2009	Q1 FY2010	Q2 FY2010	Aug 2009	Sep 2009	Oct 2009
Food Products	0.6	-25.2	-17.2	-5.2	-5.7	-9.5	2.4
Beverages, Tobacco and Related Products	12.2	12.5	-6.2	2.2	5.8	-2.7	0.5
Cotton Textiles	-3.5	-4.3	-1.7	4.3	5.6	7.1	10.7
Wool, Silk and man-made fibre textiles	1.3	0.5	4.8	21.8	20.1	12.1	12.9
Jute and other vegetable fibre Textiles (except cotton)	-23.2	-6.3	-16.2	-18.0	-10.2	-15.8	-15.5
Textile Products (including Wearing Apparel)	3.8	8.7	8.2	12.1	23.0	8.7	16.3
Wood and Wood Products; Furniture and Fixtures	-10.0	-16.3	14.7	-0.4	-3.5	1.1	18.9
Paper & Paper Products and Printing, Publishing & Allied Industries	1.3	-2.8	3.6	-0.3	-0.3	-2.3	0.7
Leather and Leather & Fur Products	-10.5	-13.0	-3.5	4.9	-0.5	-0.9	2.4
Basic Chemicals & Chemical Products (except products of Petroleum & Coal)	-4.6	8.8	2.0	13.8	14.6	20.5	18.7
Rubber, Plastic, Petroleum and Coal Products	-0.9	2.7	10.6	14.6	21.4	10.0	14.5
Non-Metallic Mineral Products	1.9	1.7	8.3	4.9	7.4	0.9	1.1
Basic Metal and Alloy Industries	5.0	-2.0	7.7	5.9	8.5	5.5	2.4
Metal Products and Parts, except Machinery and Equipment	-0.4	-16.8	-4.8	1.8	3.4	-7.6	8.8
Machinery and Equipment other than Transport equipment	4.7	10.3	7.2	14.5	14.6	16.6	18.3
Transport Equipment and Parts	-10.9	-1.5	6.9	11.4	13.6	9.8	18.9
Other Manufacturing Industries	5.6	-2.7	14.9	12.6	10.5	24.5	0.9
Mining	2.0	0.9	6.8	9.0	11.0	7.4	8.2
Manufacturing	0.5	0.3	3.4	9.4	11.0	10.0	11.1
Electricity	2.9	3.0	6.0	7.5	10.6	7.9	4.7
General	0.8	0.5	3.8	9.2	11.0	9.6	10.3

Source: CSO, IMAcS Analysis

State of the Economy

In terms of use-based classification, there has been a sharp recovery from June 2009, with strong recovery in all sub-sectors. There has been a noticeable acceleration in basic and intermediate goods segments. Although the performance of capital goods has improved, it still lags the high growth achieved during 2003-07. The continuous rise in intermediate goods production indicates pick up in upstream industries and strength in inventory investments.

Growth of Manufacturing Groups (Use-based)

(yoy)

	Q3	Q4	Q1	Q2	Aug	Sep	Oct
	FY2009	FY2009	FY2010	FY2010	2009	2009	2009
Basic	2.4	0.4	6.3	6.9	9.6	6.5	5.0
Capital	3.8	5.0	2.0	8.3	8.7	13.3	12.2
Intermediate	-5.8	-2.7	7.4	11.7	14.2	11.2	14.3
Total	3.3	1.2	-0.5	9.9	10.5	9.4	11.8
Consumer Durables	-1.8	5.6	15.6	22.2	22.3	22.2	21.0
Consumer Non Durables	4.9	-0.1	-5.3	5.4	6.4	4.4	8.1
General	0.8	0.5	3.8	9.2	11.0	9.6	10.3

Source: CSO, IMAcS Analysis

INVESTMENT INFLOWS

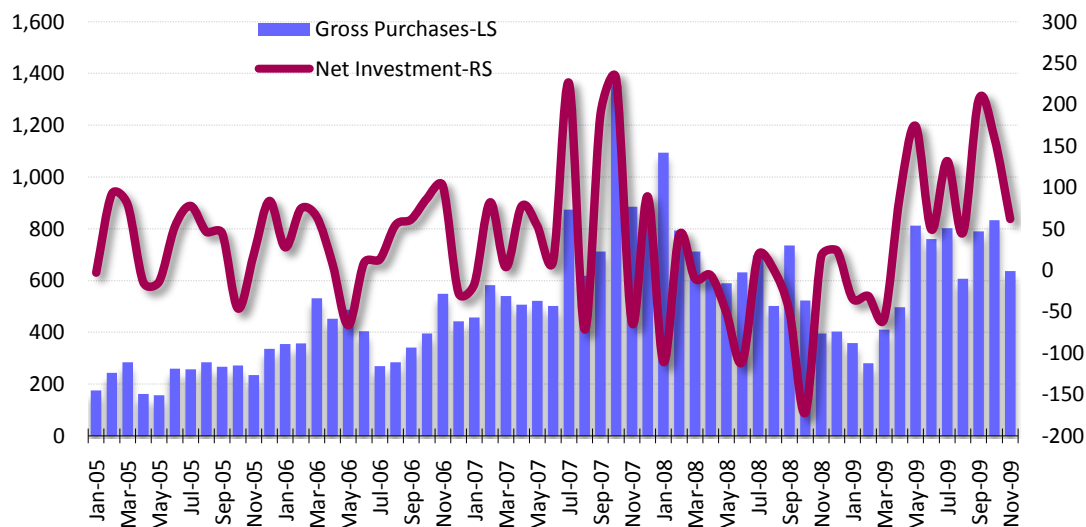
India's increased financial integration in global financial markets and flows is reflected in particular in large and rapidly growing portfolio equity inflows from foreign institutional investors (FIIs). FIIs are allowed to invest in the primary and secondary capital markets in India through a specific scheme (portfolio investment scheme) under which they can acquire shares/convertible debentures of Indian companies through the stock exchanges in India. As a result, co-movements of prices on the Indian stock exchanges and those on overseas exchanges have become stronger. For example, while the correlation of returns on broad Indian stock market indices and those on global stock market indices were low in the 1980s, there seems to have been a trend increase in this measure, especially during the present decade.

According to the data released by the SEBI, FIIs have made net purchases of Rs. 917.34 billion (US\$19.12 billion) in the Indian market during 8MFY2010 (April-November 2009) as compared with net sales of Rs. 357.30 billion (US\$8.86 billion) during 8MFY2009. The FIIs had made net sales of Rs. 458.11 billion in the Indian equity market during FY2009 as against net purchases of Rs. 661.79 billion during FY2008. With the increased integration of Indian capital markets with global capital markets, India's equity market indices also now closely follow changes in global indices. Net FII flows to Indian equity markets peaked at Rs. 231 billion in October 2007. Following the sharp decline in world equity markets in September 2008, gross purchases by FIIs declined sharply from Rs. 735 billion in September 2008 to Rs. 523 billion in October 2008. As a result, net outflows by FIIs reached a record Rs. 172 billion in October 2008. Further, FIIs net investments were negative during September 2008-March 2009, with FII's net investments being at a negative figure of US\$7.62 billion. However, FIIs net investments turned positive from April 2009, attributable to the recovery in domestic stock markets following the international trends and comparatively better growth prospects in India. Although the BSE Sensex has increased 59.5% (yoy) till October 2009, it increased 54% during April-October 2009.

Overall, emerging markets such as India experienced large portfolio outflows at the end of 2008, and outflows for emerging markets as a whole are likely to continue over the near-term, given continued pressures for leveraged investors to shed assets, the risk of further redemptions from emerging market funds, and crowding out from government-guaranteed mature market bonds. On balance, emerging markets will likely see net private capital outflows in 2009, with chances of a recovery in 2010 and 2011.

Investment by FII's

Rs. billion

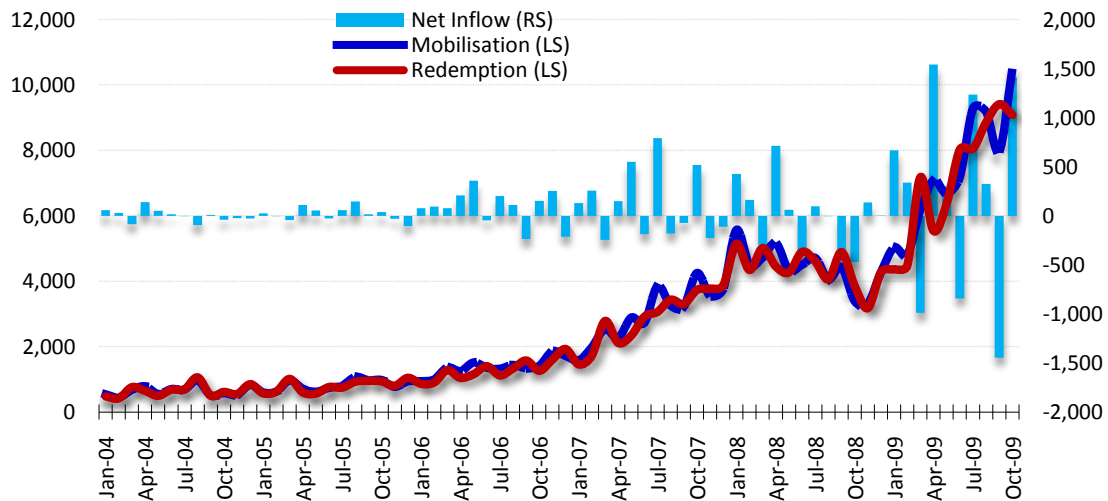


Source: SEBI, ImaCS Analysis

Net resource mobilisation by mutual funds (MFs) which reached a peak of Rs. 1,538 billion in FY2008 turned negative in FY2009, with negative net resource mobilisation of Rs. 283 billion. MFs reported large negative flow during September-October 2008, with outflows of Rs. 924.46 billion. However, with the recovery in Indian stock markets, MFs reported an improvement in inflows, with net inflows of Rs. 2,537.19 billion in 7MFY2010 (April-October 2009), compared with net inflows of Rs. 21.35 billion in Q4FY2009, and net outflows of Rs. 329.09 billion in Q3FY2009.

Investment in Domestic MFs

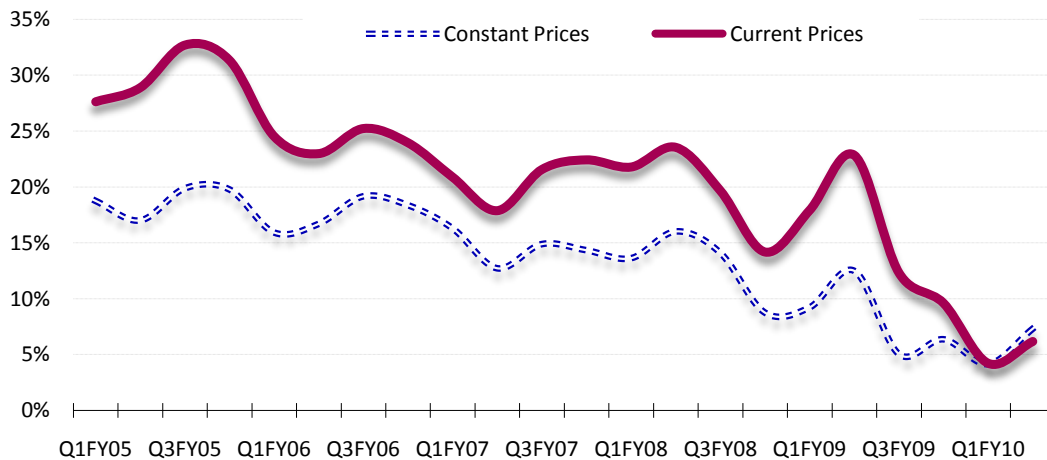
Rs. billion



Source: SEBI, IMAcS Analysis

The sharp decline in availability of foreign funds and sharp fall in corporate profits during 2008-09 meant significant curtailment of planned investments. As can be seen from the figure below, growth in gross fixed capital formation (GFCF) declined sharply from its peak of 16% in Q2FY2008 to 6.4% in Q4FY2009, and 4.2% in Q1FY2010. Although real GFCF increased 7.4% (yoy) in Q2FY2010, it still represents a significant decline from the growth rates achieved till mid-2008. Global sectors, such as steel, petrochemicals, automotive, and metals, form a large percentage of the capex, and IMAcS capex from these sectors has increased slowly because of overcapacity.

Yoy Growth in GFCF



Source: GoI, IMAcS analysis

CREDIT CONDITIONS

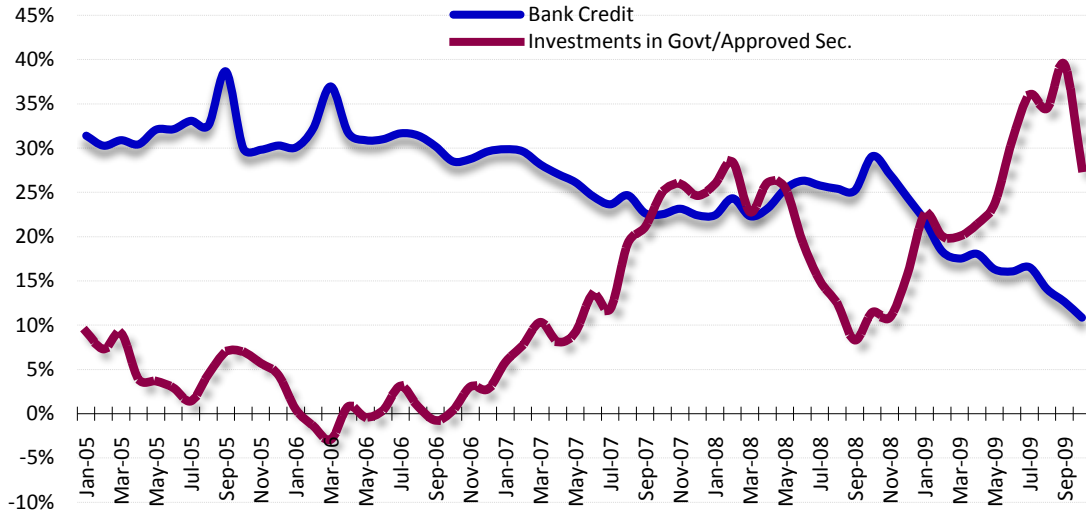
Beginning from mid-September 2008, the Indian financial markets came under severe pressure owing to the knock-on effects of the global crisis. The contagion was initially felt in the equity markets due to the reversal of foreign institutional portfolio flows. With sharp tightening of global liquidity, Indian banks and corporates saw their overseas financing drying up. As a means of substitute financing, corporates withdrew their investments from domestic money market mutual funds (MFs), thereby putting redemption pressure on them and on non-banking finance companies (NBFCs) where the MFs had invested a significant portion of their funds. This substitution of overseas financing by domestic financing brought both money market and credit market under pressure.

In response, the RBI initiated several measures since September 16, 2008 to augment domestic and foreign exchange liquidity. The RBI's monetary policy response to the global crisis impinging on India was to keep the domestic money and credit markets functioning normally and ensure that the liquidity stress did not trigger solvency issues. The need to maintain a comfortable rupee liquidity position, to augment foreign exchange liquidity and to ensure credit delivery to all productive sectors of the economy marked a reversal of RBI's earlier policy stance of monetary tightening in the first half of 2008-09 to monetary easing in the second half.

Continued Slowdown in Credit Growth

In recent years, bank credit yoy growth peaked ~30% during 2006, but subsequently moderated to ~25% by mid-2008. However, the deterioration in the global financial conditions since September 2008 and capital outflows tightened domestic liquidity conditions. Bank credit growth slowed down from 30.7% in October 2008 to 17.5% by March 2009, and 15.8% in May 2009, reflecting tighter credit conditions, continued high interest rates, and slowing down of economic growth. Significantly, yoy credit growth in May 2009 was the lowest since March 2004. Although credit growth has subsequently increased to 17% in July 2009, this growth could not be sustained and credit growth fell to 10.8% (yoy) in October 2009. In absolute terms, credit increased Rs. 1,240.21 billion during April-October 2009, compared with Rs. 2,540.67 billion during April-October 2008. In absolute terms, credit declined month on month during November 2008, January 2009, and April 2009. Bank credit to Government has however grown at a high level driven by higher market borrowings by the Government, lower growth in bank credit, and ample liquidity. Scheduled commercial bank's investment in SLR securities as a per cent of their net demand and time liabilities (NDTL) increased to 30.4% on October 9, 2009, compared with 25.7% a year-ago. Excess SLR investments of SCBs increased to Rs. 2,912.79 billion as on October 9, 2009 from Rs. 269.33 billion a year ago.

Yoy Growth in Bank Credit and Investment in Govt./other approved securities

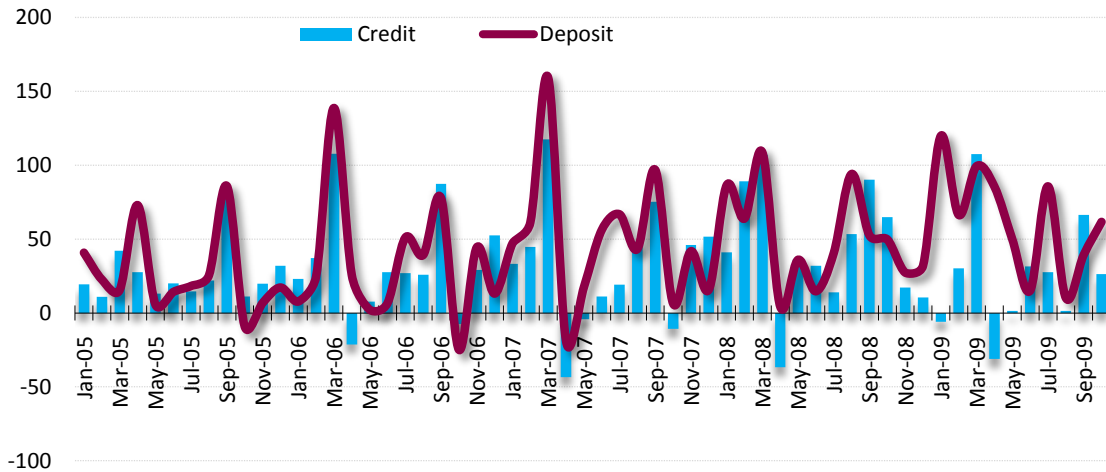


Source: RBI, IMAcS analysis

Although credit growth has decelerated sharply, deposit growth has continued to be high at 19.8% (yoy) in October 2009. However, deposit growth has declined from mid-2009 primarily because of lower growth in time deposits. The lower expansion in credit relative to the expansion in deposits resulted in a decline in the credit-deposit (C-D) ratio from 74.2 at end-September 2008 to 69.3 at end-October 2009. The decline in C-D ratio has been attributable to a sharp slowdown in mom incremental credit. In fact, on a mom basis, incremental credit declined from Rs. 976 billion in October 2008 to an absolute incremental decline of Rs. 61 billion in November 2008, even as deposit accretion also declined sharply. Although incremental credit increased Rs. 1,076 billion in March 2009 because of seasonal effects, it declined in April 2009, before increasing modestly in May 2009, and at higher rates subsequently.

Incremental Credit and Deposits of SCBs

Rs. Billion, monthly change



Source: RBI, IMAcS Analysis

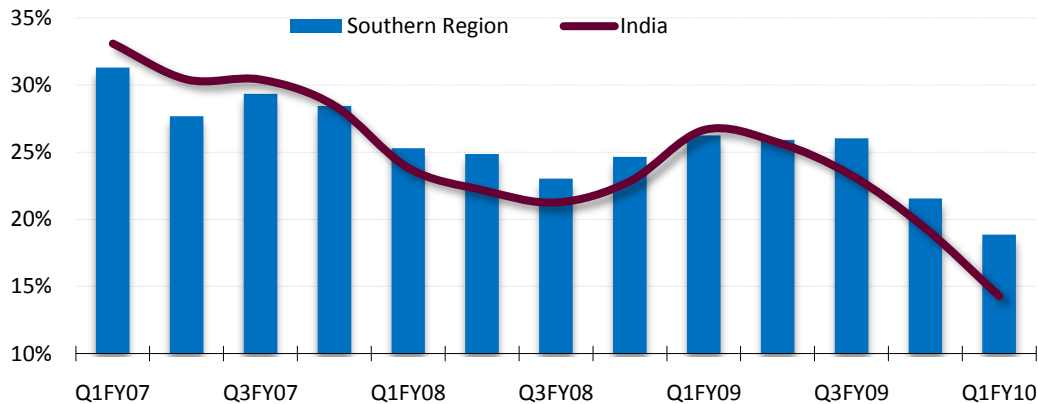
Southern Region Growth in Credit and Deposits

The RBI publishes regional- and state-wise trends in Aggregate Deposits and Gross Bank Credit of Scheduled Commercial Banks (SCBs) based on Basic Statistical Return-7. This data is published on a quarterly basis, with data being available up to June 2009.

Quarterly credit data indicates a yoy slowdown in credit growth, from 25.7% (yoy) at end-September 2008 to 23.3% (yoy) at end-December 2008, 19.3% (yoy) at end-March 2009, and 14.3% (yoy) at end-June 2009. Initially, the decline was initially primarily in the Northern and Western regions, but by March 2009, the decline was significant across all regions. Credit in the southern region increased 18.9% (yoy) in April-June 2009, compared with 21.6% (yoy) in January-March 2009, and ~26% (yoy) during July-December 2008. Credit growth has slowed down since FY2008. However, the slowdown has been lower in Southern India than the rest of the country.

Yoy Growth in Bank Credit

End of quarter



Source: RBI, IMAcS analysis

The following table provides details of end-quarter trends in deposits and credits in the Southern Region. As can be seen from the table below, credit growth up to Q3FY2009 has been steady in almost all the Southern states, with acceleration in AP. However, credit growth decelerated in Karnataka and Kerala. Subsequently, credit growth in the southern region declined appreciably with significant to moderate slowdown in almost all states.

Trends in Deposits and Credits

	Rs. Billion			Growth (yoy)		
	Q3 FY2009	Q4 FY2009	Q1 FY2010	Q3 FY2009	Q4 FY2009	Q1 FY2010
Deposits						
SOUTHERN REGION	7,811	8,623	8,567	22.3%	22.8%	19.1%
AP	1,956	2,175	2,129	24.3%	22.5%	16.9%
Karnataka	2,336	2,567	2,576	20.8%	22.0%	20.9%
Kerala	1,225	1,352	1,358	20.7%	23.9%	21.0%
TN	2,241	2,470	2,444	23.3%	23.5%	18.0%
Lakshadweep	4	5	5	38.9%	47.2%	45.5%
Puducherry	49	55	55	10.6%	15.9%	18.0%
ALL-INDIA	35,573	39,373	39,653	21.0%	21.9%	21.1%
Credit						
SOUTHERN REGION	7,101	7,623	7,613	26.0%	21.6%	18.9%
AP	1,955	2,122	2,133	35.5%	30.5%	27.4%
Karnataka	1,809	1,967	1,938	21.6%	19.9%	16.0%
Kerala	778	816	813	17.6%	14.6%	12.8%
TN	2,531	2,690	2,701	25.3%	18.6%	16.6%
Lakshadweep	0	0	0	0.0%	4.0%	8.3%
Puducherry	26	28	29	25.7%	21.8%	19.3%
ALL-INDIA	26,595	28,575	27,884	23.3%	19.3%	14.3%

Source: RBI, IMAcS analysis

Short-Term World Financial Outlook

Global financial conditions appear to have eased in the course of 2009. An increase in risk appetite has led to a rally in stock prices in world and Indian markets, and a compression in corporate bond spreads. Money market interest rates have also fallen and securities markets have posted some signs of vitality. Although cuts in policy interest rates, continued provision of ample liquidity, credit easing, public guarantees, and bank recapitalisation have appreciably lowered concerns about systemic failure and have supported intermediation; confidence in the banking system remains depressed, and bank lending worldwide and in India has continued to post lower growths in the third quarter of 2009. It could take some more time for the unprecedented measures implemented so far to bear fruit and translate into a durable normalisation of financial markets.

As noted above, confidence in the health of the banking system remains fragile in spite of recent improvements, with the cost of insuring bank debt against default remaining high despite some recent easing. As an encouraging sign, concerns reflected in bank credit default swap rates have

State of the Economy

become less systemic and more institution-specific. There are still substantial banking capitalisation needs going forward. As of date, capital injections in banks have helped compensating for losses and write-downs that have been realised so far. However, banks will still need to absorb accumulating credit losses, especially as a result of the economic downturn that is putting upward pressure on default rates across the various types of loans, in particular real estate. Moreover, bank capital will also have to be raised to levels that help rebuild confidence in the sector and are consistent with emerging regulatory

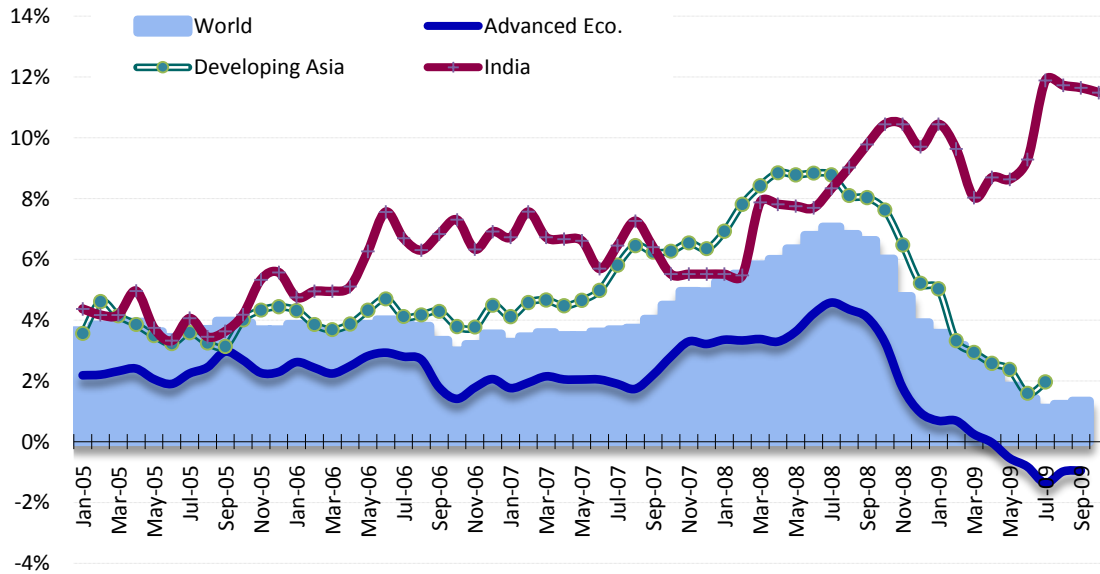
Bank lending worldwide has continued to lose ground up to the third quarter of 2009, and credit has weakened further across all segments of borrowers in the US and the euro area, including consumer loans in the US. In Japan, loans to nonfinancial corporations have trended up recently as firms started relying more heavily on previously committed credit lines and the Bank of Japan implemented a programme to provide liquidity to banks against the collateral of corporate debt at the current policy rate. A scheme to lend short-term funds to banks to facilitate their lending to firms has provided Yen 6.9 trillion yen (1.4% of GDP) by September 2009 and will be phased out at the end of March 2010. The Bank of Japan has also recently voted to provide Yen 10 trillion yen in short-term loans to commercial banks to bolster liquidity. The central bank has left the short-term policy rate unchanged at 0.1% since December 2008. However, a sharp fall in corporate profitability in the first half of 2009 has caused further scaling down of investment plans. Further, equity prices remain below their pre-September 2008 levels, resulting in negative wealth effects, and adversely affecting spending and investments. Credit is likely to remain subdued until economic activity starts gathering momentum, house prices reach a bottom, and bank lending standards become less constraining.

INFLATIONARY CONDITIONS

Sharp Decline in Global Prices and Inflation since late-2008

During the first half of FY2009, headline inflation continued to increase in major economies (including India), reflecting the combined impact of higher food and fuel prices as well as strong demand conditions, especially in emerging markets. According to IMF International Financial Statistics, world consumer price inflation (CPI) also increased sharply from 3.5% at end-2006 to a recent peak of 7.1% in July 2008. Subsequently, from around September 2008, world inflation decelerated sharply to 1.1% in July 2009 as international energy and commodity prices declined substantially on a (yoy) basis and demand pressures eased following the impact of global financial crisis. The downturn in world economic growth and more favourable seasonal conditions for agricultural production also led to large (yoy) falls in prices for minerals, ores and metals and for agricultural raw materials and food, respectively, from their peak levels in spring and summer 2008. Inflation has also moderated significantly across emerging economies, although in some cases falling exchange rates have moderated the downward momentum. Although world inflation rate plunged to 1.1% in July 2009, it has increased to 1.3% in September 2009.

World CPI

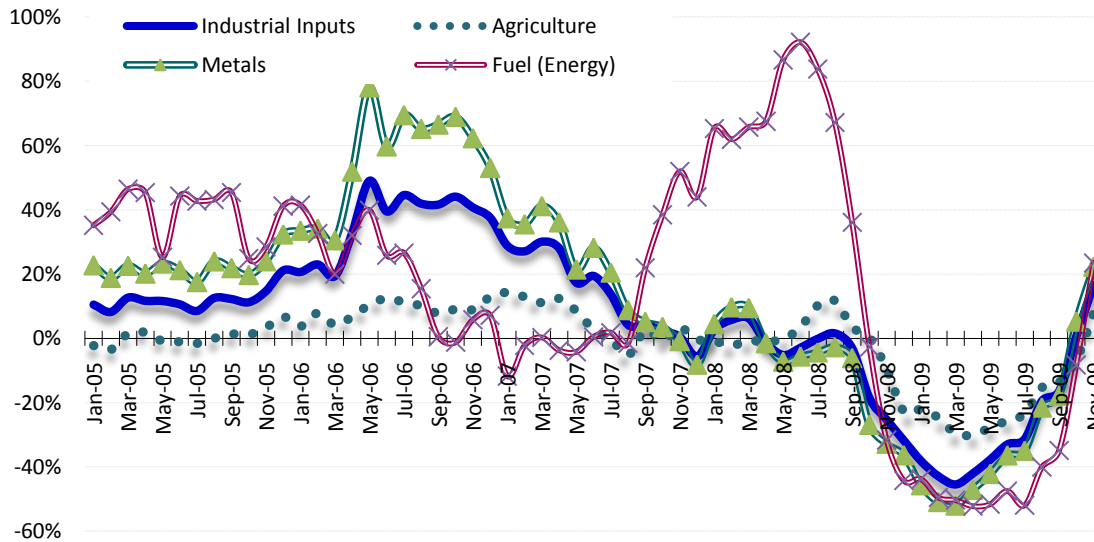


Source: IMF, IMAcS Analysis

Inflation pressures have subsided quickly, as output gaps have widened and food and fuel prices have dropped. The sharp decline in inflation has been driven by a sharp (yoy) decline in commodity prices, and weakening demand prospects.

Growth in World Commodity Prices

yoy



Source: IMF, IMAcS Analysis

Short-Term Outlook

While oil prices in November 2009 of US\$78/barrel (bbl) are around 42% below their July 2008 peak they have significantly rebounded in recent months, with the average prices increasing 88% during January-November 2009. Buoyant oil demand outside the OECD economies, and falling OPEC oil supply are the major factors behind this development. More recently, market sentiment that the slump in economic activity has bottomed out and stronger Chinese crude oil imports and demand, might also have played a role. While this may largely reflect restocking of strategic reserves at a period of relatively low crude oil prices, it also hints at some firming in Chinese economic activity in the near term. However, oil prices are not expected to rebound to their 2008 highs. In its October 2009 edition of the *World Economic Outlook*, the IMF has forecast oil prices to decline 37% in 2009 to average US\$61.5/bbl, with an increase of 24% in 2010 to US\$76.5/bbl. Relatively high spare capacity and crude oil inventories as well as subdued oil demand on account of weak macro-economic activity will contribute to keeping oil prices significantly below the elevated levels witnessed in the recent past. However, with high oil price volatility and considerable uncertainty about supply and demand, actual oil price developments are subject to a large degree of uncertainty. In particular, there is a considerable risk that rising oil demand notably from China, in combination with OPEC supply restraint could put further upward pressure on prices. Indeed, the oil futures curve suggests further price increases over the next two years. However, the predictive power of oil futures for spot prices is notoriously low.

Prices for all important industrial metals have bottomed out and most of them have posted strong gains over recent months. Again, this recovery is in part attributable to rising Chinese imports. Food prices have rebounded as well, reflecting strong Chinese and Indian import demand, weather concerns and planting delays. Overall, prices for non-oil commodities are expected to increase especially for sugar, rice, and edible oils.

Although the risks of sustained deflation have diminished over the past quarter because of upward pressure from recovering commodity prices, global inflation is expected to remain subdued during 2009 and 2010, because of significant excess capacity. However, the IMF has recently noted that risks for sustained deflation have receded. World inflation rates are likely to decline from their recent peak of 6% in 2008 to 2.5% in 2009, and are likely at 2.8-2.9% during 2010-11, because of weak output and demand prospects. In emerging economies, inflation is forecast at around 5.5% during 2009 and 4.9% in 2010, compared with 9.3% in 2008. Inflation in advanced economies is projected to be at 0.1% in 2009 and to increase to about 1.1% in 2010, largely reflecting rising commodity prices. Prices for many manufactured goods are expected to continue declining for some time. Further, in advanced economies such as the US, inflation rates could persist for a time below the levels that best foster economic growth and price stability in the longer term.

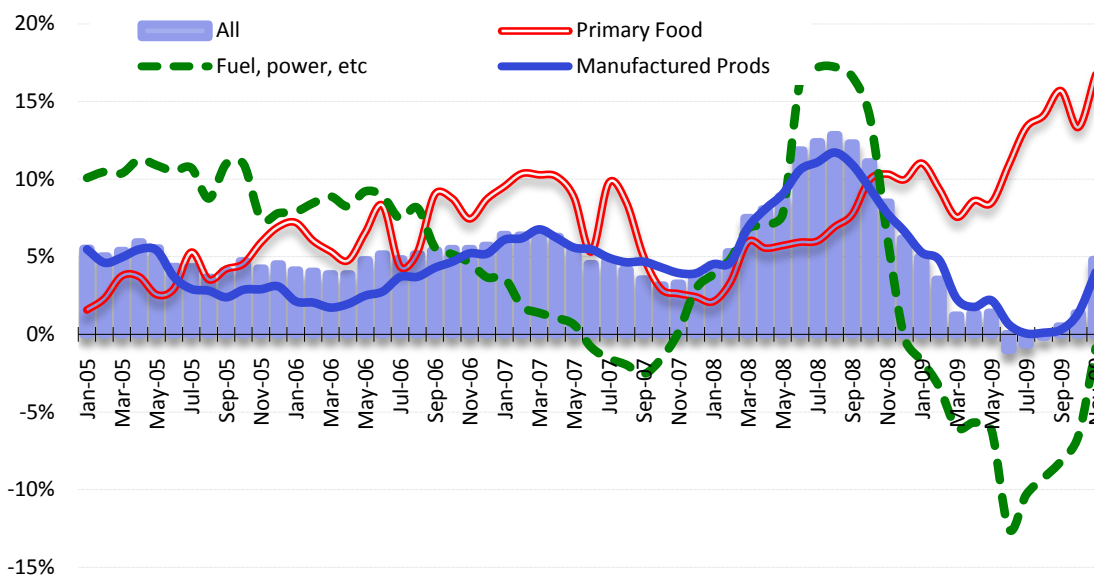
Recent Increase in Domestic Headline Inflation; Consumer Price Inflation Remains High

During 2008, the headline inflation rate, based on wholesale price index (WPI) hardened from 4.5% in January 2008 to 12.8% in August 2008. Subsequently, the RBI increased the cash reserve ratio (CRR) by a total of 100 basis points (bps) between May and July 2008 to 8.75%. Furthermore, the repo rate under the LAF was increased by a total of 75 bps to 8.50% in June 2008. Further increases in repo rates and CRR were effected in July-August 2008. Simultaneously with the sharp contraction in world

State of the Economy

economy since late-2008, headline inflation declined sharply till around August 2009. Since then, headline inflation has increased but was still at a low 1.3% in October 2009. The sharp decline in inflation been primarily driven by decline in fuel prices, and a sharp slowdown in WPI for manufactured products. The yoy growth in WPI for manufactured products (with a weight of 63.75 in WPI) declined swiftly from a thirteen-year peak of 11.8% in August 2008 to 0% in July 2009, before increasing to 1.3% in October 2009, and 4.8% in November 2009. The WPI for food articles has remained high and in fact has increased in recent months, primarily because of emerging shortages in many food products such as edible oils, sugar, and cereals. Much of the recent increase in both wholesale price and consumer price inflation has been driven by higher food prices stemming from shortfalls that had begun to emerge in 2009, and were magnified by the likely shortfall in agricultural output caused by deficient monsoon rainfall. The turnaround in international commodity prices has also contributed to the rebound in wholesale prices of food articles and manufactured products.

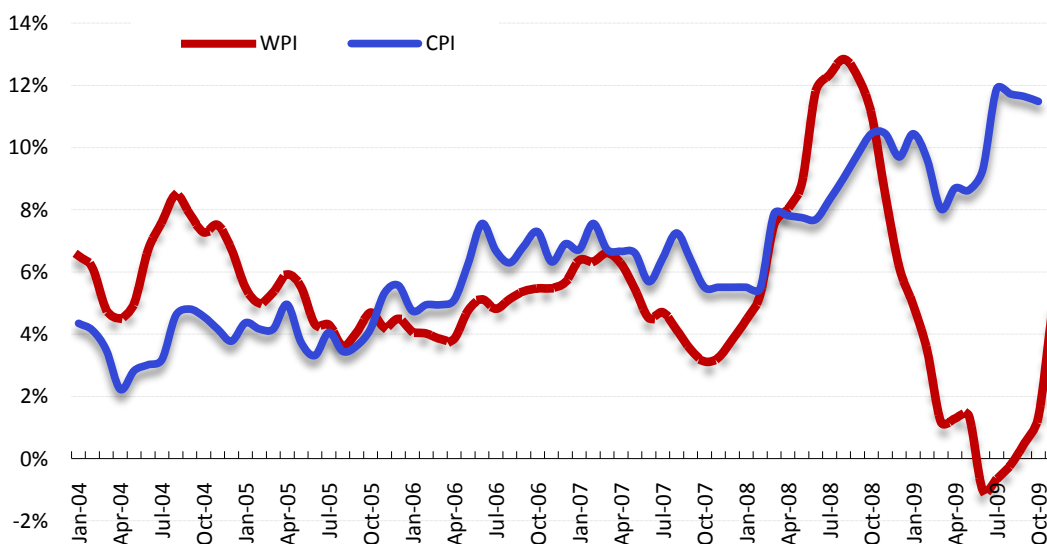
Yoy Growth in WPI



Source: Office of the Economic Advisor, IMAcS Analysis

The analysis of the last four years suggests that WPI inflation and CPI inflation moved, by and large, in tandem till April 2007. Thereafter, inflation measured in WPI and CPI have tended to diverge. However, the divergence in the recent period has been unusually high reflecting the volatilities in commodity prices which have a higher weight in WPI. While food items get the maximum weight ranging from 46% in CPI-IW (industrial workers) to 69% in CPI-AL (agricultural labourers), food articles in the primary group and food products in the manufactured group in the WPI series together have a weight of only 27%. Inflation, based on yoy variation in consumer price indices (CPIs), has increased since June 2008 mainly due to increase in the prices of food, fuel and services (represented by the 'miscellaneous' group). Various measures of consumer price inflation, though started declining, have still remained high in the range of 11.5% during October 2009, compared with 10.4% in October 2008. The higher level of consumer price inflation as compared to WPI inflation in recent months could be attributed to higher prices of food articles which have higher weight in CPIs.

India—Yoy Growth in WPI and CPI



Source: Gol, IMAcS Analysis

With the recent increase in WPI inflation, CPI inflation is expected to remain firm in the coming months. The expected sharp decline in kharif agricultural output is likely to have a more lasting impact on prices owing to the importance of some agricultural products, such as sugar and cereals, as inputs for processed food products. Further, as the domestic demand-led recovery gathers momentum, manufactured goods inflation could also increase as manufacturers could pass on higher input costs to consumers.

Keeping in view the global trend in commodity prices and domestic demand-supply balance, the RBI has projected WPI inflation to be around 4% by March 2010. However, the WPI inflation is expected to be in the positive territory in the latter part of 2009-10. On a weekly basis, the annual rate of inflation became negative from June 2009, but turned positive from mid-August 2009, primarily because of high food articles inflation. Further, there has been an upward revision of prices of petrol and diesel (effective July 2, 2009), and increase in prices of freely priced products under the fuel group in line with hardening of crude oil prices. Even the negative rate of WPI should not be interpreted as deflation for policy purposes. This negative inflation in India has only statistical significance and is not a reflection of demand contraction as is the case in advanced economies. This transitory WPI inflation in negative zone has not persisted beyond mid-August 2009. The consumer price inflation as reflected in various indices is expected to moderate from its present high level but would continue to remain in positive territory through 2009-10. The RBI's conduct of monetary policy during 2009-10 would continue to condition and contain perception of inflation in the range of 4.0-4.5% so that an inflation rate of around 3% becomes the medium-term objective, consistent with India's broader integration into the global economy.

Weekly and Monthly Trends in WPI

	All Comm.	Primary Food	Primary Non-Food	Fuel, Power, Light & Lubricants	Manfd. Products
Weekly					
05-Sep-09	0.41%	14.80%	-2.71%	-8.45%	0.34%
12-Sep-09	0.33%	14.69%	-3.72%	-8.45%	0.43%
19-Sep-09	0.62%	13.97%	-3.63%	-7.91%	0.87%
26-Sep-09	0.41%	13.48%	-4.17%	-7.91%	0.63%
03-Oct-09	0.88%	12.60%	-3.01%	-6.85%	1.16%
10-Oct-09	1.21%	13.34%	-1.17%	-6.80%	1.26%
17-Oct-09	1.51%	12.85%	0.30%	-6.20%	1.56%
24-Oct-09	NA	13.39%	-0.25%	-6.20%	NA
31-Oct-09	NA	13.68%	-0.17%	-1.71%	NA
07-Nov-09	NA	14.55%	0.59%	-1.51%	NA
14-Nov-09	NA	15.58%	1.92%	-1.51%	NA
21-Nov-09	NA	17.47%	2.22%	0.00%	NA
28-Nov-09	NA	19.05%	3.31%	0.06%	NA
Monthly					
Jun-09	-1.01%	10.89%	0.12%	-12.53%	0.64%
Jul-09	-0.67%	13.31%	-2.92%	-10.34%	0.05%
Aug-09	-0.17%	14.08%	-3.05%	-9.26%	0.10%
Sep-09	0.50%	15.69%	-3.19%	-8.18%	0.29%
Oct-09	1.34%	13.32%	-0.76%	-6.55%	1.36%
Nov-09	4.78%	16.71%	1.87%	-0.89%	3.99%

Source: Gol, IMAcS Analysis

TRADE TRENDS

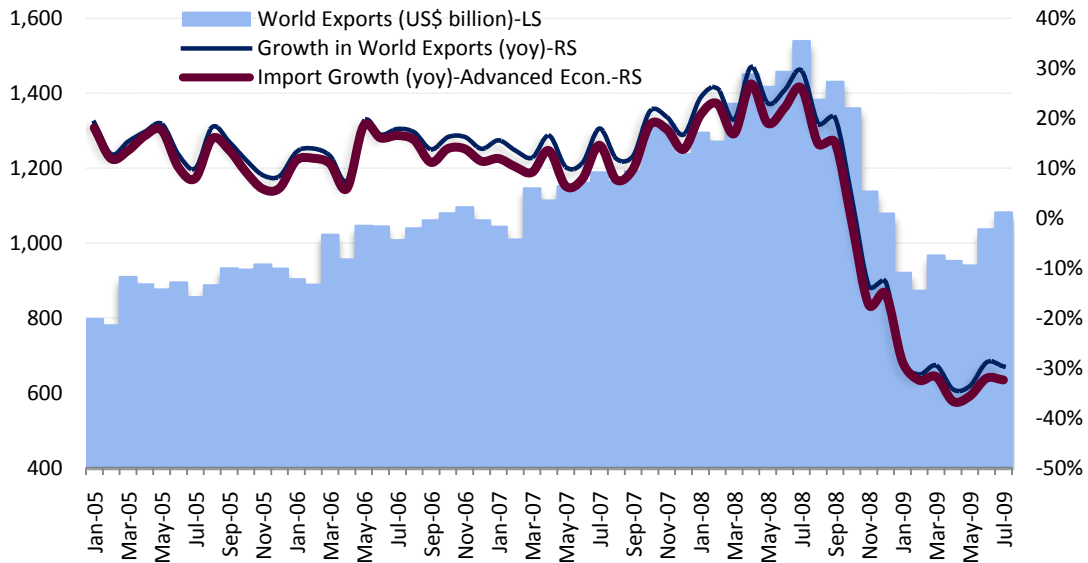
Sharp Contraction in World Trade since late-2008, but recent stabilisation

According to the IMF's International Financial Statistics, world merchandise exports, in dollar terms, grew by 27% (yoy) during 2Q2008, but growth moderated to 23% (yoy) in 3Q2008. Subsequently, exports declined 6.3% (yoy) in 4Q2008, 29.3% (yoy) in 1Q2009, and 30.8% (yoy) in 2Q2009. The contraction in exports could be attributed to declining demand, falling production and a sharp shrinkage in credit to finance trade. Overall world exports increased 15.5% in 2008, compared with 15.2% in 2007, primarily because of the higher export growth recorded in the first half of 2008. Imports by advanced economies increased 18.7% (yoy) in 3Q2008 but contracted by 11% (yoy) in 4Q2008, 31% (yoy) in 1Q2009, and 34.8% (yoy) in 2Q2009 reflecting the impact of well entrenched recession. In US\$ dollar terms, imports by advanced economies in 2Q2009 were lower by US\$1 trillion compared with 2Q2008. Exports from emerging and developing economies during 2008 grew sharply up to September 2008. However, a sharp shrinkage occurred since October 2008 which subsequently got worsened with a rapid fall in export growth emanating from deteriorating external demand, sharp fall in commodity prices and severe constraints in accessing trade credit in the international markets.

State of the Economy

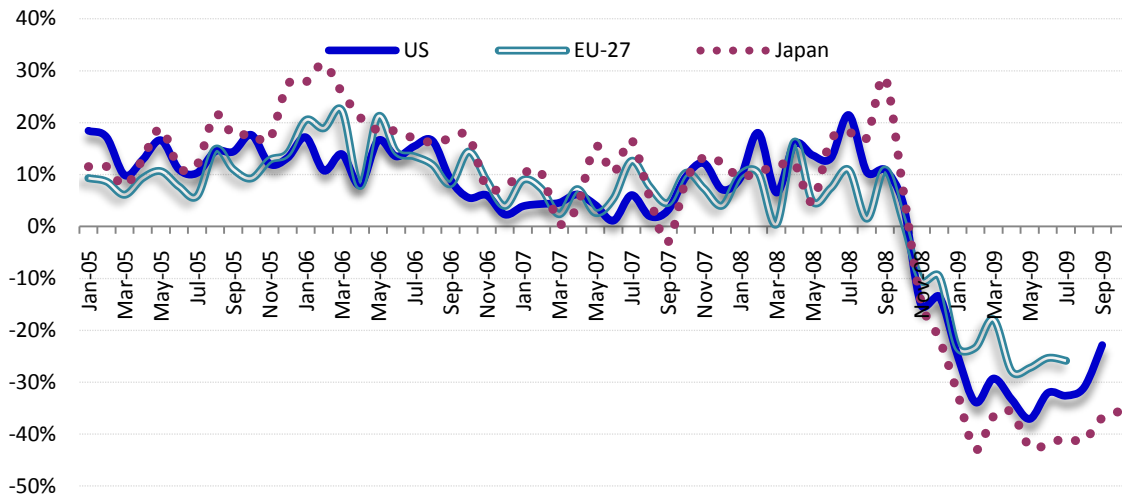
Exports from developing Asian countries had increased 22% (yoy) in 2Q2008, and 24% (yoy) in 3Q2008, but declined 1% (yoy) in 4Q2008, followed by sharp declines of 21% (yoy) in 1Q2009 and 24% (yoy) in 2Q2009.

World—Monthly Merchandise Export Growth



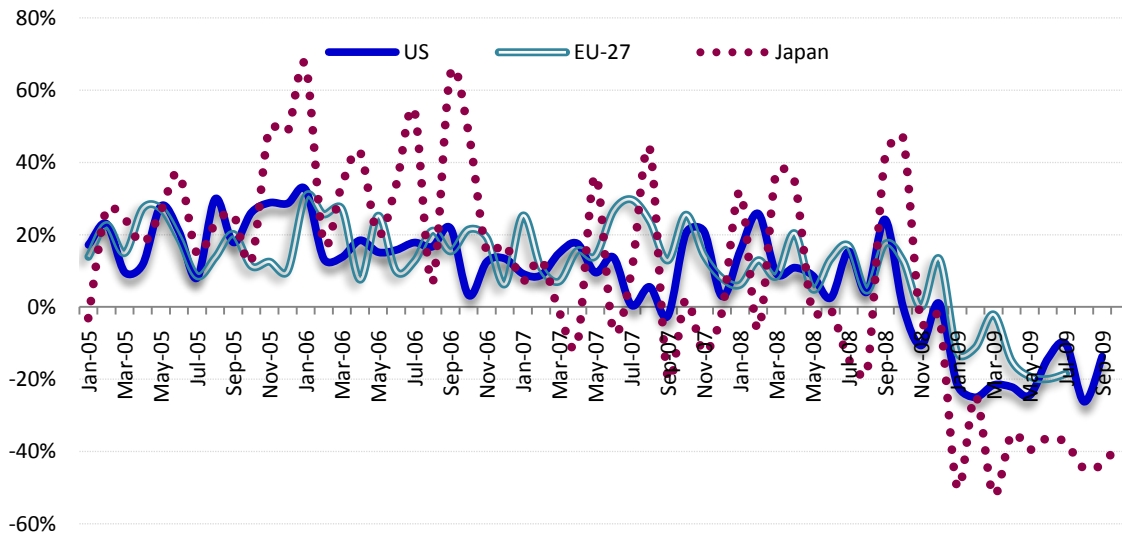
Source: IMF, IMAcS Analysis

Major Countries/Regions—Monthly Import Growth



Source: IMAcS Analysis

Major Countries/Regions—Monthly Import Growth from India



Source: IMaCS Analysis

Expected Recovery in World Output and Trade Growth in 2010

In the face of turbulent conditions in financial markets, world real GDP growth has slowed down from 5.2% in 2007 to 3% in 2008, and is expected to decline 1.1% in 2009, before recovering to an estimated growth of 3.1% in 2010, with a further increase to 4.2% in 2011. While output growth in emerging/developing countries is estimated to increase from 1.7% in 2009 to 5.1% in 2010 (down from 6% in 2008, and 8.3% in 2007), output in advanced economies is expected to decline 3.4% in 2009 but increase 1.3% in 2010 (compared with growth of 0.6% in 2008, and 2.7% in 2007). International trade has decelerated sharply in 2008 and 2009. Export opportunities for developing countries are expected to decline because of the slowdown in high-income countries and because export credits are lower and export insurance has become more expensive.

Growth Projections for Major Economies and Regions

Real GDP Growth, percent

	2007	2008	2009	2010	2011
Regions					
World	5.2	3.0	-1.1	3.1	4.2
Advanced economies	2.7	0.6	-3.4	1.3	2.5
EU	3.1	1.0	-4.2	0.5	1.8
Emerging and developing economies	8.3	6.0	1.7	5.1	6.1
Developing Asia	10.6	7.6	6.2	7.3	8.1
Countries					
China	13.0	9.0	8.5	9.0	9.7
Germany	2.5	1.2	-5.3	0.3	1.5
India	9.4	7.3	5.4	6.4	7.3
Japan	2.3	-0.7	-5.4	1.7	2.4
Brazil	5.7	5.1	-0.7	3.5	3.5
Russia	8.1	5.6	-7.5	1.5	3.0
UK	2.6	0.7	-4.4	0.9	2.5
US	2.1	0.4	-2.7	1.5	2.8

Source: IMF, World Economic Outlook, October 2009

As a result, the world trade in goods and services is expected to decline 12.2% in 2009, and increase 5.4% in 2010. Imports by advanced economies are expected to decline 13.7% in volume terms during 2009, before increasing 1.2% in 2010. Industrial production has continued to fall steeply, and weak export orders in exporting nations indicate that import demand in advanced economies is likely to remain depressed. Export volumes of developing countries are expected to decline 7.2% in 2009, before increasing 3.6% in 2010. The (yoy) sharp decline in commodity prices will hurt primary exporters in particular, but lower import demand in the developed countries will affect export growth throughout the developing world.

The exceptional contraction of world trade is expected to gradually ease and come to a halt by end 2009, with a recovery projected in 2010. The expected recovery is based on the following expectations

- ❑ credit conditions will remain at the levels observed from the second quarter of 2009 for the rest of the year and then improve gradually in 2010 to get back to their 1995-2008 average.
- ❑ world trade would be depressed in 2009 and then would pick up faster in 2010 because of stronger GDP growth in developed economies, and a direct positive impact of the earlier improvement in financing conditions.
- ❑ trade growth in developing economies is expected to recover earlier reflecting recoveries from the slowdown in growth in these countries. Thus, growth in Brazil, China and India is projected to rise significantly, the pick-up in China being driven by supportive policies. However, the Russian Federation is only expected to recover weakly, reflecting very large adverse external shocks and fragile confidence in banks and the currency.

Exchange Rate Trends

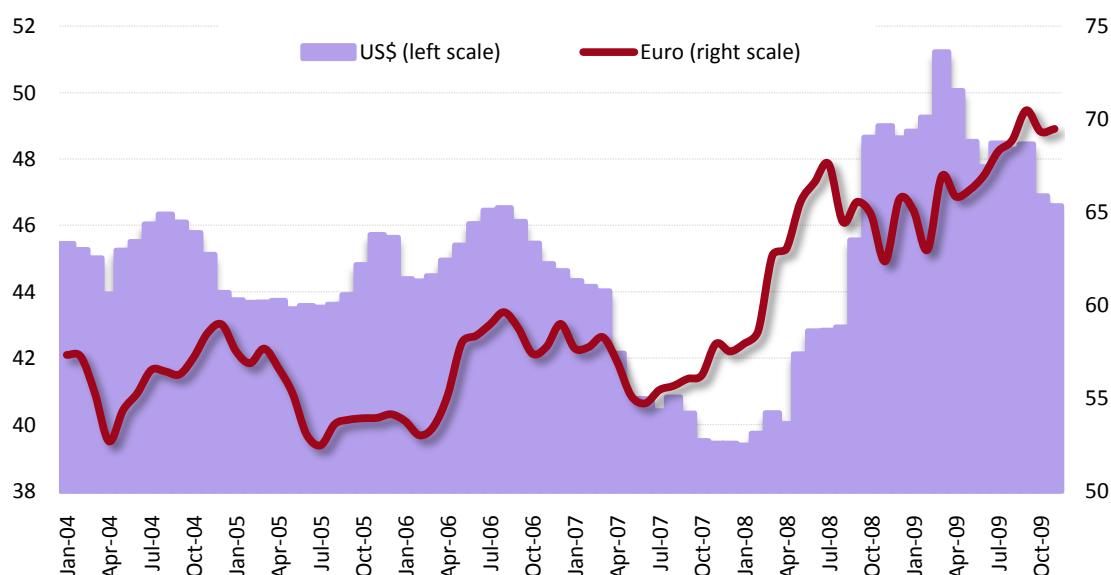
During FY2009, the Indian rupee generally depreciated. The rupee, which depreciated during Q4FY2008, appreciated thereafter. However, from around end-April 2008, the rupee depreciated

State of the Economy

continuously thereafter, reflecting large capital outflows by FIIs, increased demand for dollars by the oil companies and bearish stock market conditions. The rupee averaged 49.83 against the US\$ in Q4FY2009, compared with 48.7 in Q3FY2009, and 39.83 in Q4FY2008. During FY2010, the rupee has recovered against the US\$, averaging 48.38 during Q2FY2010, and 46.59 in November 2009. The US\$ has declined in recent months, as the US monetary policy stance has quickly been loosened. The US Federal Reserve reduced its policy rate to near zero in late-2008 and has late last year and implemented credit easing measures to support key credit markets, such as those for commercial paper and mortgages. These policies are expected to remain in place until the recovery has firmed. However, such government support is expected to result in US federal government budget deficit likely to exceed 10% of GDP in 2009, up from 2.25% in 2007 before the current recession. The federal government deficit is likely to remain above 10% of GDP in 2010, reflecting the path of fiscal support measures.

Exchange Rate of the Rupee

Rs. Per unit



Source: Gol, IMAcS Analysis

Sharp Contraction in India's Trade since September 2008

Provisional data on India's merchandise trade is available up to October 2009. However, commodity-wise and country-wise details are available only up to March 2009.

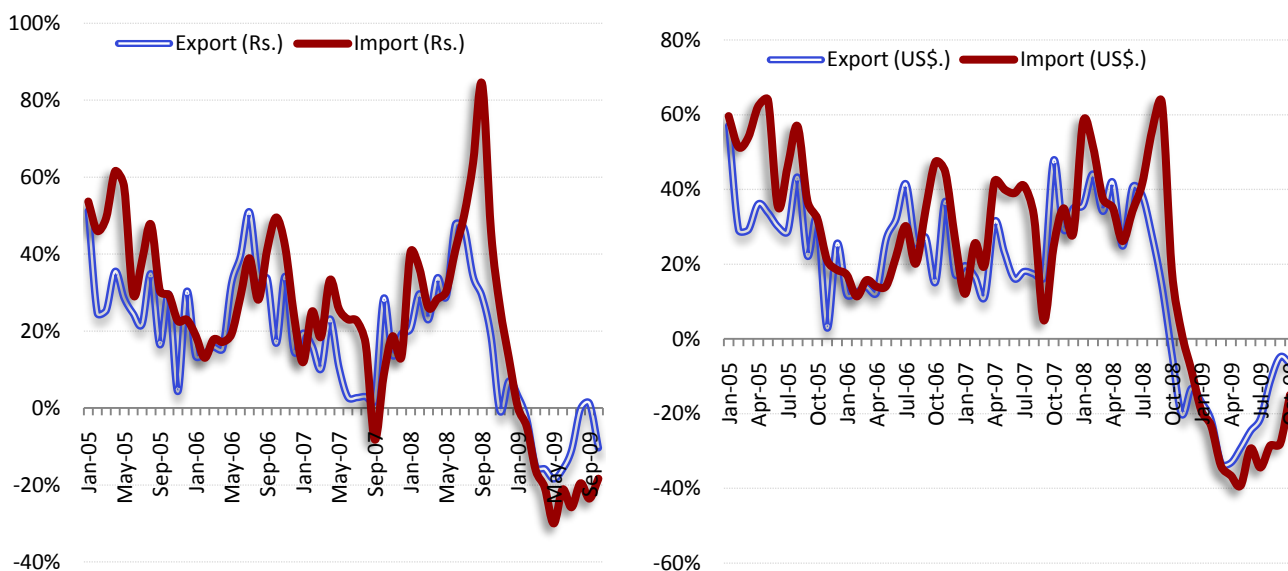
After growing a high rate till September 2008, India's merchandise trade has contracted significantly with high rates of declines in both exports and imports. In US\$ terms, merchandise trade started contracting from October 2008, and the rate of contraction accelerated up to July 2009. Since then, although exports have continued to decline on a (yoy) basis, the rate of contraction has declined with exports declining 6.6% (yoy) in October 2009, compared with a recent peak decline of 33.2% (yoy) in April 2009. In rupee terms, trade started contracting from January 2009, and the rate of decline has been high, though there was a sharp improvement during August-September 2009. In rupee terms,

State of the Economy

trade growth has moderated sharply from 62% (yoy) in September 2008 to 1.4% (yoy) in January 2009, and was negative during February-October 2009. However, in US\$ terms, trade growth plunged from October 2008 onwards, and has been negative since November 2008, with trade declining 30% (yoy) in July 2009. Since then, the rate of decline has been lower with trade in US\$ terms declining 12% (yoy) in October 2009. Import growth has also moderated sharply because of sharply lower commodity prices and reduced import volumes.

India—Monthly Merchandise Trade Growth

yoy growth



Source: GoI, IMAcS Analysis

Trade Declined Sharply for both Petroleum and Other Commodities

India's merchandise exports during October 2009 at US\$13.19 billion recorded a yoy decline of 6.6% as against a decline of 3.7% registered in the corresponding month of the previous year. In rupee terms, exports declined 10.3% (yoy) in October 2009 to Rs. 616.39 billion, compared with a growth of 18.6% in the corresponding previous. With exports recording a steady decline since October 2008, overall exports during 7MFY2010 (April-October 2009), at US\$91.05 billion declined 26%. This sharp decline was on account of deceleration/ decline in the export of textiles and textile products, gems and jewellery, leather products and agriculture and allied products and iron ore and minerals as these sectors have been adversely affected under the impact of demand recession, mainly in the developed regions.

Imports during October 2009 at US\$21.99 billion also showed substantial decline by 15% (yoy) as against an increase of 18.5% (yoy) in October 2008, due to decline in both oil and non-oil imports, with the decline in non-oil imports being higher than oil imports in recent months. Imports have

recorded a steady decline since December 2008 and the overall imports during 7MFY2010 at US\$148.37 billion, experienced a decline of 29.6%.

Quarterly Trends in India's Merchandise Trade

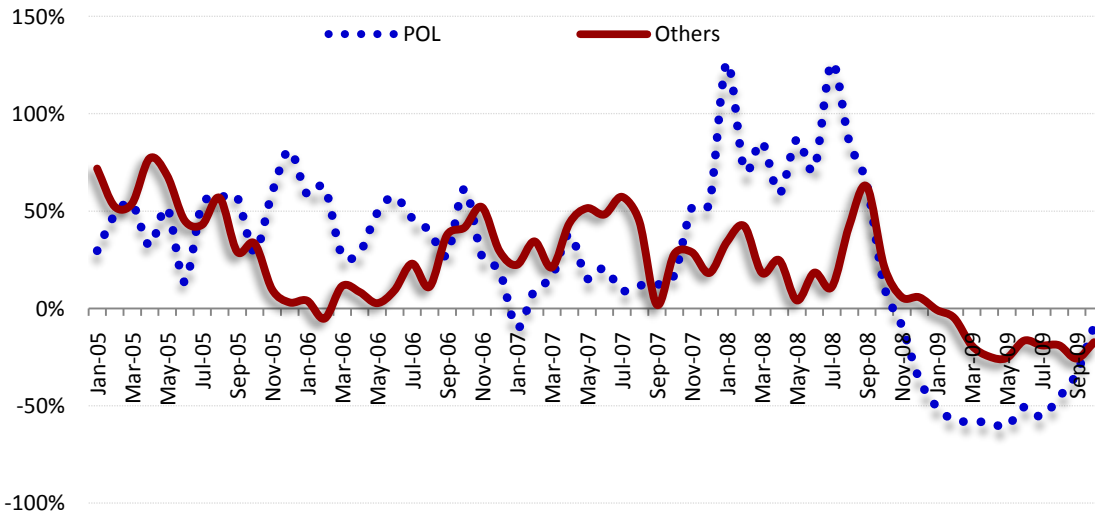
	Rs. Crores		Growth		US\$ million		Growth	
	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports
Q1FY05	79,387	106,894	25.8%	28.6%	17,674	23,777	31.8%	34.6%
Q2FY05	86,411	117,350	28.4%	42.7%	18,721	25,424	27.9%	42.2%
Q3FY05	94,174	129,371	24.4%	35.8%	20,961	28,804	26.0%	37.6%
Q4FY05	115,367	147,450	32.2%	49.7%	26,396	33,735	36.7%	54.9%
Q1FY06	102,686	158,571	29.3%	48.3%	23,550	36,371	33.2%	53.0%
Q2FY06	107,150	162,404	24.0%	38.4%	24,520	37,165	31.0%	46.2%
Q3FY06	114,142	161,592	21.2%	24.9%	25,150	35,599	20.0%	23.6%
Q4FY06	132,271	172,053	14.7%	16.7%	29,784	38,743	12.8%	14.8%
Q1FY07	132,664	193,008	29.2%	21.7%	29,155	42,431	23.8%	16.7%
Q2FY07	148,971	220,962	39.0%	36.1%	32,126	47,663	31.0%	28.2%
Q3FY07	138,261	223,082	21.1%	38.1%	30,742	49,573	22.2%	39.3%
Q4FY07	151,884	203,454	14.8%	18.3%	34,391	46,068	15.5%	18.9%
Q1FY08	147,877	245,292	11.5%	27.1%	35,884	59,536	23.1%	40.3%
Q2FY08	152,683	242,014	2.5%	9.5%	37,675	59,712	17.3%	25.3%
Q3FY08	166,574	252,774	20.5%	13.3%	42,210	64,054	37.3%	29.2%
Q4FY08	188,730	272,232	24.3%	33.8%	47,364	68,352	37.7%	48.4%
Q1FY09	202,200	326,747	36.7%	33.2%	48,631	78,362	35.5%	31.6%
Q2FY09	208,575	399,748	36.6%	65.2%	47,742	91,352	26.7%	53.0%
Q3FY09	180,976	325,506	8.6%	28.8%	37,128	66,749	-12.0%	4.2%
Q4FY09	178,142	252,714	-5.6%	-7.2%	35,810	50,840	-24.4%	-25.6%
Q1FY10	168,431	248,171	-16.7%	-24.0%	34,567	50,936	-28.9%	-35.0%
Q2FY10	201,023	308,197	-3.6%	-22.9%	41,520	63,659	-13.0%	-30.3%

Source: GoI, IMaCS Analysis

Petroleum, oil and lubricants (POL) imports during 7MFY2010 at US\$42.86 billion, declined by 39.3% (yoy), primarily because of a sharp decline in crude oil prices since September 2008. However, the significant increase in crude oil prices during 2009 has resulted in the rate of decline being sharply lower at 9.1% (yoy) in October 2009, compared with 46% (yoy) in Q2FY2010, and 57% (yoy) in Q1FY2010. Non-oil imports during 7MFY2010 at US\$105.50 billion registered a decline of 24.8% (yoy) mainly due to deceleration/decline in the growth in non-bulk imports, viz., capital goods and gold and silver. Commodity price declines, especially of fertilisers, edible oils, coal, chemicals, and electronic goods have also contributed to the decline in exports. Overall, although POL imports declined from the second half of FY2009 mainly due to lower prices, other imports also declined at a high rate, reflecting worsening domestic and export demand prospects.

India—Monthly Import Growth

yoy growth in US\$

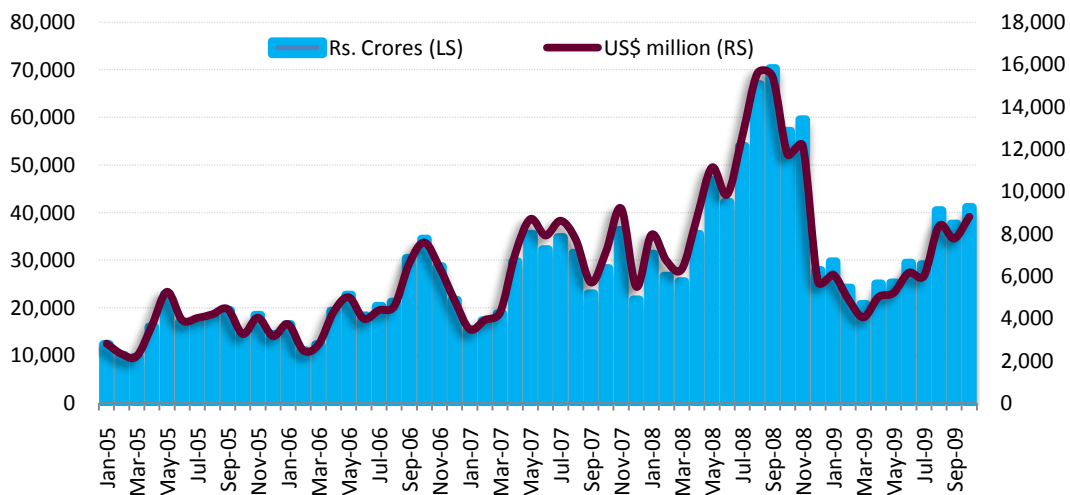


Source: Gol, IMAcS Analysis

Sharp Contraction in Trade Deficit during the latter half of FY2009, Rise in Recent Months

The trade deficit narrowed by US\$30.51 billion during 7MFY2010 to US\$57.32 billion. In rupee terms, trade deficit narrowed by Rs. 1,065.78 billion to Rs. 2,767 billion. However, exports have declined at a higher rate than imports since early-2009 resulting in a recent increase in trade deficit. There was a sharp contraction of the trade deficit—from a peak of US\$15.58 billion (Rs. 669.09 billion) during August 2008 to a recent low of US\$4.05 billion (Rs. 207.20 billion) in March 2009. Trade deficit has subsequently increased in March-July 2009 mainly because of a month on month (mom) increase in oil imports since May 2009.

India's Trade Deficit



Source: Gol, IMAcS Analysis

Commodity-wise Export Trends

Commodity wise trade trends are available only up to March 2009. For FY2010, a recent analysis by the Ministry of Commerce indicates that the following sectors have continue to remain relatively unaffected by the global slowdown, with increase in exports in US\$ terms during 7MFY2010: man-made yarn/fabric/made ups (growth of 1.2%); tobacco (20.5%); fruits and vegetables (5.7%).

Further, some export commodities which were significantly impacted by global slowdown, have recently begun to show a turnaround with positive (yoy) growth in October 2009. These include: Plastic and Linoleum (growth of 13.2%), Drugs and Pharmaceuticals (9.3%), Marine Products (3.7%), Iron ore (250%), Spices (18.2%), Oil meal (19.8%), Cashew (20.6%), and Petroleum products (7.8%).

Some export commodities which were significantly impacted by global slowdown have shown lower rate of decline in October, 2009 as compared to earlier months. These include Cotton yarn/fabrics/ made ups (decline of 9.7% in October 2009), Handicrafts (-8.5%), Basic chemicals other than pharmaceuticals (-13%), Gems and Jewellery (-16.8%), Leather and Leather manufactures (-13.8%), Engineering goods (-14.7%), Electronic goods (-9.9%), and Tea (-7%).

BALANCE OF PAYMENTS TRENDS

BOP Trends for Q1FY2010

Current Account

As can be seen from India's BOP statistics, preliminary data for Q1FY2010 indicate that the merchandise trade deficit contracted sharply from its peak of US\$38.7 billion in Q2FY2009 to US\$14.6 billion in Q4FY2009, but increased to US\$26 billion in Q1FY2010, as imports increased even as exports continued to decline. On a BOP basis, India's merchandise exports recorded a lower but sharp yoy decline of 21% in Q1FY2010, compared with a decline of 24.2% in Q4FY2009. However, imports declined at a lower rate of 19.6% in Q1FY2010, compared with a decline of 27.3% in Q4FY2009. The lower decline in Q1FY2010 is primarily because of rebound in crude oil prices.

Although merchandise trade deficit increased in Q1FY2010, invisibles receipts and payments increased marginally. Invisibles receipts from services declined primarily because of a decline in software services receipt reflecting the impact of global economic slowdown. Invisibles receipts registered a yoy decline of 0.7% in Q1FY2010 compared with a (yoy) decline of 16.6% in Q4FY2009 on account of a decline in almost all categories of services (except insurance and financial services), official transfers and investment income receipts. In net terms, the invisibles balance of US\$20.18 billion during Q1FY2010 was marginally lower than that in the corresponding period of the previous year (US\$22.41 billion). Overall services exports, however, witnessed a decline of 2.9% (yoy) in Q1FY2010, compared with a decline of 6.6% (yoy) in Q4FY2009. Following a decline of 12.7% (yoy) in Q4FY2009, software services receipts declined by 11.5% (yoy) in Q1FY2010. When compared with the performance in the first three quarters of 2008-09, software exports at US\$10.76 billion in Q1FY2010 were substantially lower than average software exports of US\$11.94 billion recorded in the first three quarters of 2008-09. Invisibles payments increased 11.9% (yoy) in Q1FY2010 mainly led by sharp increases in payments under insurance, business services, financial services, and communication services account.

State of the Economy

Summarised BOP Balance

US\$ million, Net

Item	FY2009				FY2010
	Q1	Q2	Q3	Q4	Q1
I. MERCHANDISE	-31,425	-31,425	-34,704	-14,598	-25,986
II. INVISIBLES (a+b+c)	22,406	22,406	21,671	19,345	20,179
a) Services of which	11,618	11,618	13,152	10,991	9,038
b) Transfers	11,653	11,653	10,150	9,586	12,878
c) Income	-865	-865	-1,631	-1,232	-1,737
A. TOTAL CURRENT ACCOUNT (I+II)	-9,019	-9,019	-13,033	4,747	-5,808
1. Foreign Investment (a+b)	4,756	4,756	-5,376	492	15,101
a) Foreign Direct Investment	8,967	8,967	444	3,185	6,833
b) Portfolio Investment	-4,211	-4,211	-5,820	-2,693	8,268
2. Loans (a+b+c)	4,215	4,215	884	-3,598	-3,357
a) External Assistance	351	351	992	777	84
b) Commercial Borrowings	1,467	1,467	3,884	1,117	-356
c) Short Term to India	2,397	2,397	-3,992	-5,492	-3,085
3. Banking Capital (a+b)	2,696	2,696	-4,956	-3,261	-3,365
a) Commercial Banks	2,847	2,847	-4,527	-3,372	-3,127
b) Others	-151	-151	-429	111	-238
4. Rupee Debt Service	-30	-30	-	-68	-23
5. Other Capital	-502	-502	5,182	1,147	-1,620
B. TOTAL CAPITAL ACCOUNT (1 to 5)	11,135	11,135	-4,266	-5,288	6,736
C. ERRORS AND OMISSIONS	119	119	-582	841	-813
D. OVERALL BALANCE	2,235	2,235	-17,881	300	115

Source: RBI, IMAcS analysis

With the increase in invisibles payments accompanied by a (yoy) decline in invisibles receipts, the net invisibles (invisibles receipts minus invisibles payments) was marginally higher by US\$834 million in Q1FY2010 than in Q4FY2009. At this level, the invisibles surplus financed about 77.7% of trade deficit during Q1FY2010, compared with 71.3% during Q1FY2009, and 132.5% during Q4FY2009.

Overall, the net surplus under invisibles not only fully financed the lower trade deficit observed during Q4FY2009 but also led to a surplus in the current account; last recorded during Q4FY2007. However, this positive development could not be continued into Q1FY2010. Despite net invisibles surplus of US\$20.18 billion in Q1FY2010, the large trade deficit mainly on account of sharp decline in exports led to a current account deficit of US\$5.81 billion (Rs. 283.36 billion) in Q1FY2010, compared with a surplus of US\$4.75 billion (Rs. 236.28 billion) in Q4FY2009.

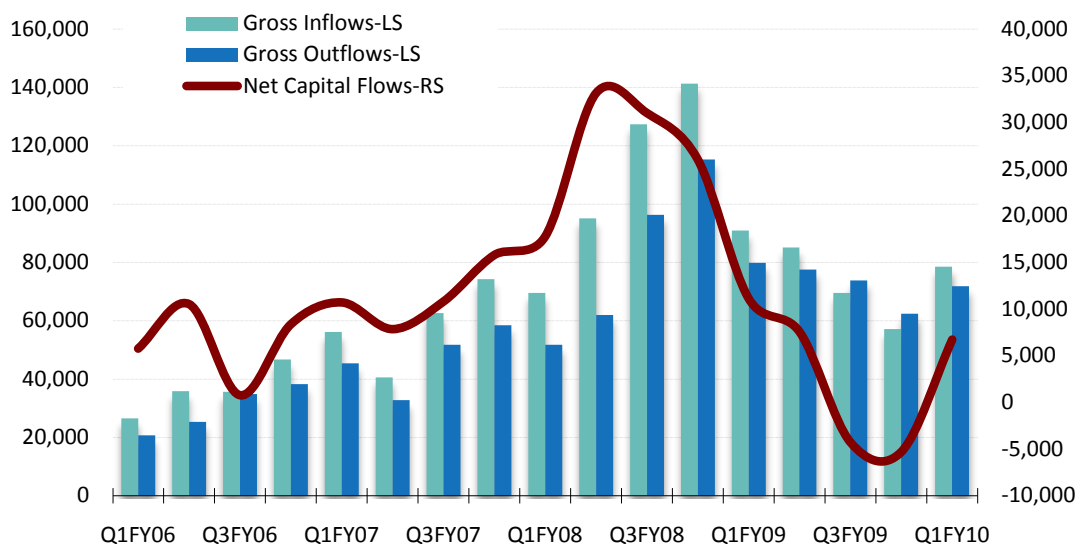
Capital Account

Reversing the trend of negative capital account balance during Q3FY2009 and Q4FY2009, the capital account showed a positive balance of US\$6.74 billion (Rs. 328.64 billion) in Q1FY2010. Gross capital inflows to India revived during Q1FY2010. Although gross inflows increased from US\$57.09 billion in Q4FY2009 to US\$78.49 billion in Q1FY2010, they were lower than US\$90.87 billion in Q1FY2009.

Compared with Q4FY2009, gross inflows increased in Q1FY2010 led by a 78.2% quarter on quarter (qoq) increase in foreign investments and 29.5% (qoq) increase in banking capital.

Trends in Capital Flows

US\$ million



Net FDI inflows (net inward FDI minus net outward FDI) have increased sharply from a recent low of US\$444 million in Q3FY2009 to US\$3.19 billion in Q4FY2009, and to US\$6.83 billion in Q1FY2010. The increase has been accounted by an increase in inward FDI accompanied by a decline in outward FDI. During Q1FY2010, FDI to India was mainly into manufacturing sector (19.2%), real estate activities (15.6%), financial services (15.4%), construction (12.2%), and business services (11.7%). Mauritius continued to be the major source of FDI during Q1FY2010 with a share of 48.9%, followed by US (12.8%).

Portfolio investment primarily comprising foreign institutional investors' (FIIs) investments and American Depository Receipts (ADRs)/Global Depository Receipts (GDRs) witnessed a sharp turnaround from net outflows for five consecutive quarters till Q4FY2009 to net inflows of US\$8.27 billion in Q1FY2010. This is primarily accounted for by gross FII investments which after plunging from US\$73.81 billion in Q4FY2008 to US\$18.56 billion in Q4FY2009, increased to US\$38.56 billion in Q1FY2010. The tightness in liquidity in the overseas markets continued during Q1FY2010. The approvals of external commercial borrowings (ECBs) were very low in the first two months of 2009-10, however, it recovered during June 2009.

Banking capital mainly consists of foreign assets and liabilities of commercial banks. NRI deposits constitute major part of the foreign liabilities. Banking capital (net), including NRI deposits, were negative at US\$3.37 billion during Q1FY2010, as against a positive net inflow of US\$2.7 billion during Q1FY2009, and negative flow of US\$3.26 billion in Q4FY2009. However, among the components of banking capital, NRI deposits witnessed higher gross flows in Q1FY2010 (compared with Q4FY2009) reflecting the positive impact of the revisions in the ceiling interest rate on NRI deposits.

Detailed BOP Statistics

US\$ billion

Item	Q4FY2009			Q1FY2010		
	Credit	Debit	Net	Credit	Debit	Net
I. MERCHANDISE	39.82	54.42	-14.60	38.79	64.78	-25.99
II. INVISIBLES (a+b+c)	37.66	18.32	19.35	38.68	18.51	20.18
a) Services of which	24.26	13.27	10.99	22.39	13.35	9.04
Travel	2.68	2.61	0.07	2.29	2.00	0.28
Transportation	2.92	2.50	0.42	2.49	2.78	-0.29
Insurance	0.35	0.33	0.02	0.39	0.31	0.07
Miscellaneous	18.23	7.48	10.75	17.13	8.15	8.97
of which Software Services	11.18	0.45	10.73	10.76	0.39	10.37
b) Transfers	10.01	0.42	9.59	13.34	0.47	12.88
i) Official	0.16	0.11	0.05	0.05	0.11	-0.06
ii) Private	9.84	0.31	9.54	13.30	0.36	12.94
c) Income	3.40	4.63	-1.23	2.95	4.69	-1.74
i) Investment Income	3.21	4.31	-1.11	2.72	4.35	-1.63
ii) Compensation of Employees	0.19	0.32	-0.13	0.23	0.34	-0.11
A. TOTAL CURRENT ACCOUNT (I+II)	77.48	72.73	4.75	77.47	83.28	-5.81
1. Foreign Investment (a+b)	27.07	26.58	0.49	48.24	33.14	15.10
a) Foreign Direct Investment (i+ii)	8.41	5.23	3.19	9.61	2.78	6.83
i. In India	8.07	0.06	8.01	9.49	0.03	9.46
ii. Abroad	0.34	5.17	-4.83	0.12	2.75	-2.63
b) Portfolio Investment	18.66	21.35	-2.69	38.63	30.36	8.27
i) In India	18.58	21.17	-2.59	38.60	30.33	8.27
of which FII's	18.56	21.17	-2.61	38.56	30.33	8.23
GDRs/ADRs	0.02		0.02	0.04	0.00	0.04
ii) Abroad	0.08	0.18	-0.10	0.02	0.02	0.00
2. Loans (a+b+c)	14.21	17.81	-3.60	13.04	16.40	-3.36
a) External Assistance	1.38	0.61	0.78	0.82	0.74	0.08
i) By India	0.01	0.01	0.00	0.01	0.12	-0.10
ii) To India	1.38	0.60	0.78	0.81	0.62	0.19
b) Commercial Borrowings	3.60	2.48	1.12	2.09	2.45	-0.36
i) By India	0.40	0.31	0.10	0.24	0.33	-0.09
ii) To India	3.20	2.17	1.02	1.85	2.11	-0.27
c) Short Term to India	9.23	14.73	-5.49	10.13	13.21	-3.09
i) Suppliers' Credit > 180 days & Buyers' Credit	9.23	10.45	-1.22	10.13	9.59	0.54
ii) Suppliers' Credit up to 180 days		4.28	-4.28	0.00	3.62	-3.62
3. Banking Capital (a+b)	12.03	15.29	-3.26	15.58	18.94	-3.37
a) Commercial Banks	11.92	15.29	-3.37	15.58	18.70	-3.13
of which : Non-Resident Deposits	9.33	7.15	2.18	11.17	9.35	1.82
b) Others	0.11		0.11	0.00	0.24	-0.24
4. Rupee Debt Service		0.07	-0.07	0.00	0.02	-0.02
5. Other Capital	3.78	2.63	1.15	1.64	3.26	-1.62
B. TOTAL CAPITAL ACCOUNT (1-5)	57.09	62.38	-5.29	78.49	71.75	6.74
C. ERRORS AND OMISSIONS	0.84		0.84		0.81	-0.81
D. OVERALL BALANCE	135.42	135.12	0.30	155.96	155.85	0.11

Source: RBI, IMAcS analysis

State of the Economy

The increase in foreign exchange reserves on a BOP basis (i.e., excluding valuation) was US\$115 million in Q1FY2010, as compared with increase of US\$300 million in Q4FY2009. However, the foreign exchange reserves including valuation increased by US\$13.2 billion during Q1FY2010 implying that the increase in reserves during this period was mainly due to valuation gains as the US dollar has depreciated against major currencies.

SHORT-TERM ECONOMIC OUTLOOK

Global Short-Term Outlook

The recent downturn has been global in scope, even though its financial epicentre was in the developed countries. Indeed, trade and financial linkages prompted a synchronised collapse in activity and trade after financial markets froze in the second half of 2008. De-coupling turned out to be a mirage as most of the major developing economies also slid into recession or a slowdown.

However, in recent months, economic activity in developed countries now looks to be approaching its nadir, following the deepest decline in post-World War II history. The ensuing recovery is likely to be both weak and fragile for some time. However, thanks to a strong economic policy effort, a recovery is expected in late-2009 with a strengthening in 2010. A recovery is expected to take hold in a staggered manner across countries reflecting, not least, the extent of policy stimulus. Specifically,

- A recovery that earlier appeared in most large non-OECD economies has now also spread to the OECD economies. In non-OECD economies, especially in Asia, and particularly in China and India, the recovery has been against the background of substantial monetary and especially fiscal stimuli. At the same time, these countries do not suffer from the kind of balance-sheet damage that afflicts many OECD countries. In fact, a major emerging policy issue is now the timing of withdrawal of stimulus so as to avoid igniting asset or general price inflation.
- Signs have multiplied that US activity could bottom out in the course of the second half of 2009. Such a recovery would reflect tremendous policy effort. The US economy is now gradually recovering on the back of policy stimulus, improving financial conditions, demand growth in emerging economies, stock-building, and stabilisation in housing markets. Higher asset prices could cause positive wealth effects and support consumption growth. However, as the growth impulse from fiscal stimulus fades and the need for balance-sheet repairs continues to hold back growth the recovery could be weak and insufficient to bear down on unemployment at least till around mid-2010.
- Japan's economy is also showing signs that the trade-induced contraction is close to the end, thanks not least to fiscal stimulus. However, the recovery is likely to be slow and huge economic slack and weak domestic demand is likely to further entrench deflation.
- Signs of impending recovery in the euro area are not yet as clearly visible, reflecting country specific combinations of bursting housing bubbles, export set-backs and damage to financial sectors. The eventual recovery may also be slow in this region, with unemployment continuing to rise till around end-2010. Rising unemployment is likely to make consumers more reluctant to spend.

In the OECD economies, the recession is projected to bottom out in the second half of 2009. Although real GDP is expected to decline 1% in 4Q2009, a slow recovery in activity is projected to start towards the end of 2009, with stimulatory policy settings together with a gradual normalisation of financial

conditions and a pick-up in growth in the non-OECD area helping support consumption and investment growth which will gradually gather strength in 2010. Significant rises in unemployment to 10% in the US and more than 12% in the euro area will imply significant slack, notwithstanding likely increases in structural unemployment rates due to the labour shake-out. The large slack will reduce inflation to very low levels in 2009 and 2010.

Among the major emerging economies

- The Chinese economy is already recovering from the slowdown of late 2008, with growth expected to rise to roughly 9% in 2010. The Chinese economy is now rebounding strongly from the slowdown in the autumn of 2008, primarily because of sizeable monetary and fiscal stimulus, along with some rebalancing towards domestic demand. The fiscal stimulus package introduced in November 2008 has resulted in strong growth in infrastructure investment and domestic consumption. With strong domestic demand, import growth has also increased in recent months, and given the high import content of Chinese exports, should result in a recovery in exports. However, China's budget deficit is likely to widen significantly in 2009 following the announcement of a major investment plan for 2009-10, with total outlays totalling Yuan 4 trillion (5.6% of trend GDP annually). A part thereof relates to projects that were already foreseen, notably the Yuan 1 trillion allocated to rebuilding areas devastated by the 2008 earthquake.
- Indian activity will progressively gain greater momentum. Residential investment was stagnating during 2008 but has also started to increase recently. Moderate recovery in capital formation has more than offset the continued weakness of exports and a slight deceleration of retail sales reflecting falling urban employment. As a result, industrial production has staged a marked recovery, and overall growth is likely to be only modestly impacted by the deficient monsoon rainfall. Food prices have continued to increase, notably at a higher rate because of expected shortfalls in agricultural output caused by deficient monsoon rainfall, and a recent recovery in international commodity prices.
- Activity in Brazil has strengthened in the second quarter of 2009 as domestic demand firmed due to improving credit conditions and fiscal stimulus. Monetary policy has been relaxed, following a cumulative 500 bps cut in the policy interest rate during the 12 months ended September 2009. Fiscal policy has been eased, including through a reduction in the primary budget surplus target by 130 bps to 2.5% of GDP in 2009.
- Russia is suffering a severe recession, but the rebound in commodity prices and the expected effects of policy stimulus point to some recovery through 2009 and into 2010. If oil and commodity prices remain around recent levels the current account will increase in 2010 and net private capital outflows will ease, allowing the exchange rate and foreign exchange reserves to consolidate their recent recovery. Although the delay in delivering fiscal stimulus till April 2009 aggravated the initial impact of the economic crisis; the subsequent budgeted increases in expenditure are expected to be implemented quickly.

In summary, it looks as if the worst scenario has been avoided and that developed economies are now nearing the bottom. However, financial conditions remain tight in spite of some recent easing, and the bottom of the recession is likely to be reached only in the second half of 2009, after which a weak recovery is projected. The developed economies at the end of 2010 are still expected to be faced with an exceptional degree of slack. Even if the recovery may be slow such an outcome is a major achievement of economic policy.

Domestic Outlook

RBI's Survey of Professional Forecasters, November 2009

In November 2009, the RBI released the results of quarterly Survey of Professional Forecasters on major macroeconomic indicators of medium term economic developments. The RBI has been conducting the survey on a quarterly basis from the second quarter ended September 2007. The results of the survey are summarised below:

- ❑ Forecasters have revised their real GDP growth rate downwards to 6% in 2009-10, compared with 6.5% in the August 2009 survey. The highest probability (37.5%) is assigned to growth range of 6.0-6.4% for FY2010. For FY2010, the highest probability of 49.3% has been assigned to 7.5-7.9% growth range for GDP. Real GDP growth from agriculture is forecast at -1.4% (2.5% in August 2009) in FY2010. By comparison, real GDP from agriculture increased 1.6% in FY2009, and 1.7% in H1FY2010. For FY2010, growth forecast for industry has been revised upwards from 4.8% in the last survey to 6.3% in the current survey (compared with 6.6% in H1FY2010). The forecast for services sector for FY2010 has been revised downwards from 8.3% to 8.1% (compared with 8.3% in H1FY2010).
- ❑ The profit growth of corporate sector in FY2010 has been revised upwards from 7.5% in the last survey to 10%. The growth is expected to recover to 14.5% in FY2011. Corporate profit in Q3FY2010 is expected to increase 9%, revised upwards from previous survey forecast of 8%.
- ❑ Broad money (M3) growth is revised upwards to 19% for FY2010, from the earlier forecast of 18%. In FY2010, bank credit is expected to grow at the rate of 17% against previous forecast of 18%.
- ❑ On a quarterly basis, real GDP is expected to grow at 6.2% in Q2FY2010 (actual of 7.9%), 5.7% in Q3FY2010, and 6.9% in Q3FY2010. Contribution of gross fixed capital formation to GDP has been projected at 33% in Q3FY2010, and 33.5% in Q4FY2010, compared with actuals of 36.3% in Q2FY2010.
- ❑ Forecasters' median estimates for WPI inflation on a (yoy) basis in the third and fourth quarters of current financial year are at 4%, and 6.8%, respectively.

Results of Survey

	Actuals			Forecast (Median)		
	Q1	Q2	Q3	Q4	Q1	Q2
	FY2010	FY2010	FY2010	FY2010	FY2011	FY2011
Real GDP growth rate at factor cost (per cent)	6.1%	7.9%	5.7%	6.7%	7.3%	7.6%
Agriculture & Allied Activities	2.4%	0.9%	-3.7%	-1.0%	2.0%	2.7%
Industry	4.2%	9.0%	6.9%	6.9%	6.7%	6.7%
Services	7.7%	9.0%	8.4%	8.6%	8.9%	9.1%
IIP growth rate	3.8%	9.1%	7.2%	7.4%	8.0%	7.3%
Private Final Consumption Expenditure (growth rate)	1.6%	5.6%	7.9%	8.3%	9.3%	11.0%
Gross Fixed Capital Formation (per cent of GDP at current market price)	33.5%	36.3%	33.0%	33.5%	34.5%	35.9%
Corporate profit after tax (growth rate)			9.0%	12.0%	15.0%	17.5%
US\$/INR (end period)	48.5	48.0	47.0	46.0	45.9	45.3
BSE INDEX (end period)	14,782	16,338	17,623	18,000	18,500	19,500
Export (US\$ billion)	34.57	41.52	42.2	44.7	44.0	47.6
Import (US\$ billion)	50.94	63.66	69.6	67.3	63.6	75.5
Trade Balance (US\$ billion)	-16.37	-22.14	-28.1	-22.1	-20.7	-28.9
Oil Price (in US\$/bbl)	59.2	68.2	75.0	77.6	78.5	81.0
WPI (yoy change)	0.5%	-0.1%	4.0%	6.8%	7.2%	6.5%
CPI-IW (yoy change)	8.9%	11.8%	12.0%	12.3%	11.0%	7.6%

Source: RBI, IMAcS Analysis

CII's Business Outlook Survey

According to the bi-annual Business Outlook Survey of the Confederation of Indian Industry (CII), Business Confidence Index (BCI) for October 2009-March 2010 (H2FY2010) increased by 7.4 points to 66.1 as compared to a 2.4 points increase during April-September 2009 (H1FY2010). The CII survey is based on a large sample of about 450 companies.

The rise in Index obviously indicates better expectations for the coming six months. The CII-BCI is constructed as a weighted average of the Current Situation Index (CSI) and the Expectations Index (EI). The CSI has registered a surprise increase after nearly two years of decline. CSI gained 5.9 points for H2FY2010, when compared with H1FY2010. When compared to the corresponding period last year (H2FY2009), the CSI improved by 3.4 points. The EI which reflects the expectation of Indian industry with regards to performance of their company, sector and the economy for H2FY2010 gained 8.1 points compared to H1FY2010, and by 13 points compared with H2FY2009. This suggests that businesses are optimistic about an economic rebound in H2FY2010.

The CII survey revealed that 54% of the respondents expect GDP growth for FY2010 to range between 6-7%. On inflation, 82% of the respondents expect inflation to be below 5% per cent in 2009-10, thereby suggesting that while there may be spikes in some commodity prices, inflationary risks remain low, especially given that monsoons showed some recovery towards the end. Given that the economic recovery is still at nascent stages, 80% of the respondents expect the Indian economy would witness a turnaround and begin returning to normal growth only from the second half of FY2010 and beyond.

The prospects for investment, capacity utilisation, production, employment and exports as elements that build up the business confidence were also looked into by the survey. The survey revealed that 52% of the respondents plan to increase investments in the coming six months.

Capacity utilisation has improved considerably with 58% of the respondents expecting capacity utilisation to be in the range of 75-100% for H2FY2010, compared with 41% of respondents who said that capacity utilisation was already in that range. The CII survey revealed that a lower percentage of respondents (16%) expect the inventory levels to decline as compared to the 28% that reported a decline for the past six months.

According to 70% of the respondents, the value of production is expected to increase in the next six months. Further, increase in production is likely because of expected increase in new orders. As much as 78% of the respondents expect new orders to increase in H2FY2010, compared to about 46% of the respondents who indicated revealed that new orders had increased in H1FY2010.

On exports, 55% of the respondents expressed confidence in expansion of exports for H2FY2010. Regarding procedural delays, 91% of the respondents felt that the delays had not reduced. This has been a long-standing hurdle for exporters, which raises transactions costs and needs to be addressed urgently.

The CII Business Outlook Survey also asked respondents about their main concerns, such as Global Economic Instability, High Interest Rate, Cost and Availability of labour, Infrastructure and Institutional shortages, Currency risks, Slackening Consumer Demand, Cost of Compliance, Surge in Imports and Bleak Monsoons Outlook. The average score of responses revealed that global economic instability was the top concern followed by slackening consumer demand; and infrastructural and institutional shortages.

Summing Up

After three years of +9% per annum growth in real GDP, there has been a pause in India's long economic upswing, with GDP growth having fallen to 6.4% in the 12 months ended September 2009. Following signs of slowdown from late-2008, the government introduced some new stimulatory fiscal measures at the beginning of 2009, which followed a sizeable increase in public outlays in 2008. Growth has recovered in FY2010 with real GDP increasing 7.9% in Q2FY2010, and indicators suggest that the momentum is strengthening. In 2009-10, falling exports are projected to result in some slowdown in domestic demand and output. With the gradual recovery of the global economy and easier financial conditions, growth is projected to gradually regain momentum from around Q3FY2010. However, the extent of the deterioration in the fiscal position prior to the slowdown has reduced the scope for large-scale discretionary fiscal policy action.

The impact of easier monetary conditions and the marked increase in the fiscal deficit during FY2009 and projected for FY2010 may not be sufficient to counteract the impact of expected lower exports on employment. As exports start to grow once again—under the combined impact of a weaker exchange rate, a recovery of world trade and a lower cost of capital—business investment is expected to rebound somewhat. This should eventually feed through to stronger consumption and the economy should regain momentum in late-2009. The possible increase in long-term interest rates associated



with a widening fiscal gap, at a time when inflation is now rising, could force interest rates up, which might restrain investment. On the other hand, continuation of recent trend of higher equity prices could make it easier to raise finance and might also generate wealth effects that could help the economy grow faster.

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