



Confederation of Indian Industry

CII Southern Region

Industry and Economic Update

State of the Indian Economy

January-March 2010

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REAL GDP GROWTH

New Series of National Accounts Statistics Released

On January 29, 2010, the Central Statistical Organisation (CSO), Ministry of Statistics and Programme released the Quick Estimates (QE) of national income, consumption expenditure, saving and capital formation for the FY2009. Alongwith the QE, the CSO has also introduced the new series of national accounts statistics with base year 2004-05, in place of the previous series with base year 1999-2000. While there are no major changes in the overall growth rate of GDP at constant (2004-05) prices, except for FY2008, where real GDP growth has been revised upwards from 9% to 9.2%, there are some changes in growth rates at sectoral level. Thus, for instance, the contribution of the agriculture sector to the GDP at factor cost in 2004-05 has declined from 17.4% in the old series (1999-2000) to 15.9% in the new (2004-05). Similarly, while the contribution of registered manufacturing has declined from 10.9% in the old series to 9.9% in the new series, that of unregistered manufacturing has increased from 4.9% to 5.4%.

Real GDP Growth and Share

	New Series			Old Series		
	2007	2008	2009	2007	2008	2009
Growth						
Agriculture, forestry and fishing	3.7%	4.7%	1.6%	4.0%	4.9%	1.6%
Agriculture	3.7%	4.7%	1.6%	4.0%	4.9%	1.6%
Mining & Quarrying	8.7%	3.9%	1.6%	8.8%	3.3%	3.6%
Manufacturing	14.9%	10.3%	3.2%	11.8%	8.2%	2.4%
Electricity, gas & water supply	10.0%	8.5%	3.9%	5.3%	5.3%	3.4%
Industry	13.6%	9.3%	3.1%	10.7%	7.4%	2.6%
Construction	10.6%	10.0%	5.9%	11.8%	10.1%	7.2%
Trade, hotels, transport & communication	11.7%	10.7%	7.6%	12.8%	12.4%	9.0%
Financing, insurance, real estate & bus. Services	14.5%	13.2%	10.1%	13.8%	11.7%	7.8%
Community, social & personal services	2.6%	6.7%	13.9%	5.7%	6.8%	13.1%
Services	10.2%	10.4%	9.3%	11.3%	10.8%	9.4%
GDP at Factor Cost	9.7%	9.2%	6.7%	9.7%	9.0%	6.7%
Share						
Agriculture, forestry and fishing	17.2%	16.4%	15.7%	18.5%	17.8%	17.0%
Agriculture	17.2%	16.4%	15.7%	18.5%	17.8%	17.0%
Mining & Quarrying	2.6%	2.5%	2.4%	2.1%	2.0%	1.9%
Manufacturing	16.0%	16.2%	15.6%	15.3%	15.2%	14.6%
Electricity, gas & water supply	2.0%	2.0%	2.0%	2.1%	2.0%	2.0%
Industry	20.7%	20.7%	20.0%	19.5%	19.2%	18.5%
Construction	8.0%	8.1%	8.0%	7.2%	7.2%	7.3%
Trade, hotels, transport & communication	25.6%	25.9%	26.1%	27.1%	28.0%	28.6%
Financing, insurance, real estate & bus. Services	15.8%	16.4%	16.9%	14.3%	14.6%	14.8%
Community, social & personal services	12.8%	12.5%	13.4%	13.4%	13.1%	13.9%
Services	62.2%	62.9%	64.4%	62.0%	63.0%	64.5%
GDP at Factor Cost	100%	100%	100%	100%	100%	100%

Source: Central Statistical Organisation (CSO), IMaCS Analysis

State of the Economy

Real GDP Growth Slid in Q3FY2010

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	Q3
Rs. Billion							
Agriculture, forestry and fishing	1,521	1,232	2,044	1,708	1,557	1,243	1,987
Agriculture	1,521	1,232	2,044	1,708	1,557	1,243	1,987
Mining & Quarrying	233	225	256	274	251	246	281
Manufacturing	1,583	1,610	1,611	1,692	1,636	1,758	1,842
Electricity, gas & water supply	203	204	205	207	216	219	215
Industry	2,019	2,038	2,072	2,173	2,103	2,223	2,337
Construction	804	823	824	876	861	876	896
Trade, hotels, transport & communication	2,593	2,610	2,724	2,921	2,802	2,832	2,996
Financing, insurance, real estate & bus. Services	1,667	1,690	1,770	1,886	1,803	1,820	1,908
Community, social & personal services	1,195	1,327	1,497	1,535	1,276	1,495	1,464
Services	6,259	6,450	6,815	7,219	6,741	7,024	7,264
GDP at Factor Cost	9,798	9,720	10,932	11,100	10,401	10,490	11,588
Yoy Growth							
Agriculture, forestry and fishing	3.2%	2.4%	-1.4%	3.3%	2.4%	0.9%	-2.8%
Agriculture	3.2%	2.4%	-1.4%	3.3%	2.4%	0.9%	-2.8%
Mining & Quarrying	2.6%	1.6%	2.8%	-0.3%	7.9%	9.5%	9.6%
Manufacturing	5.9%	5.5%	1.3%	0.6%	3.4%	9.2%	14.3%
Electricity, gas & water supply	3.3%	4.3%	4.0%	4.1%	6.2%	7.4%	4.9%
Industry	5.2%	4.9%	1.7%	0.8%	4.2%	9.1%	12.8%
Construction	7.1%	8.0%	3.0%	5.6%	7.1%	6.5%	8.7%
Trade, hotels, transport & communication	10.8%	10.0%	4.4%	5.7%	8.1%	8.5%	10.0%
Financing, insurance, real estate & bus. Services	9.1%	8.5%	10.2%	12.3%	8.1%	7.7%	7.8%
Community, social & personal services	8.7%	10.4%	28.7%	8.8%	6.8%	12.7%	-2.2%
Services	9.4%	9.4%	10.3%	8.0%	7.7%	8.9%	6.6%
GDP at Factor Cost	7.6%	7.5%	6.2%	5.8%	6.1%	7.9%	6.0%

Source: Central Statistical Organisation (CSO), IMAcS Analysis

However, as can be seen from the table above, real GDP growth improved marginally in Q1FY2010 followed by a strong recovery in Q2FY2010, and a slide in Q3FY2010; when real GDP increased 6%

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.

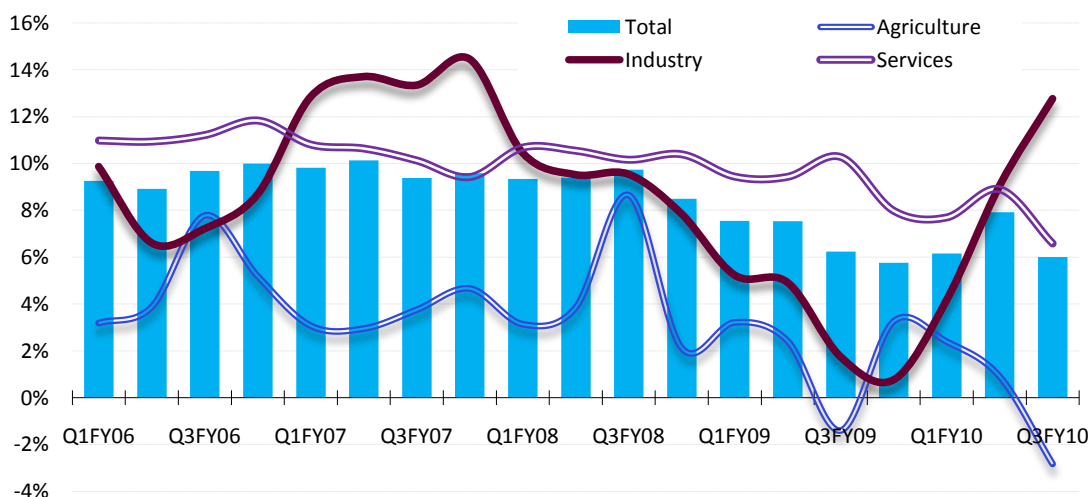
(yoy). Further, real GDP growth of 6.7% in 9MFY2010 represents a decline from growth of 7.1% in 9MFY2009.

The significant slowdown in Q3FY010 has been driven by the following factors:

- Agricultural output declined 2.8% in Q3FY2010, and overall growth is likely to remain weak in FY2010 because of the output impact of deficient monsoon.
- Services sector real GDP growth declined from 7.9% in Q2FY2010 to 6% in Q3FY2010, driven primarily by a 2.2% (yoy) decline in ‘community, social & personal services’ attributable to reduced Government spending. All other services sectors have reported higher growth in Q3FY2010 as compared with Q2FY2010. There has been a significant improvement in growth in ‘construction’, ‘trade, hotels, transport & communication’, accompanied by a marginal increase in ‘financing, insurance, real estate & business services’.
- Sharp recovery in GDP from industry from -1.4% in Q4FY2009 to 9.1% in Q2FY2010, and to 14.3% in Q3FY2010, caused by substantially higher growth in manufacturing. Real GDP growth from industry in Q2FY2010 represented the highest quarterly growth since Q4FY2007. However, real GDP growth from electricity, gas, and water supply has declined. During 9MFY2010, power generation by the power utilities monitored by the CEA increased 6.1% (yoy) to 572,722 GWh. Increase in power generation was mainly on account of increase in installed capacity as there was marginal overall change in PLF. The slower growth was primarily attributable to a 7.4% (yoy) decline in hydro power generation caused by deficient monsoons.

Quarterly Growth in GDP

Percent, at constant (2004-05) prices



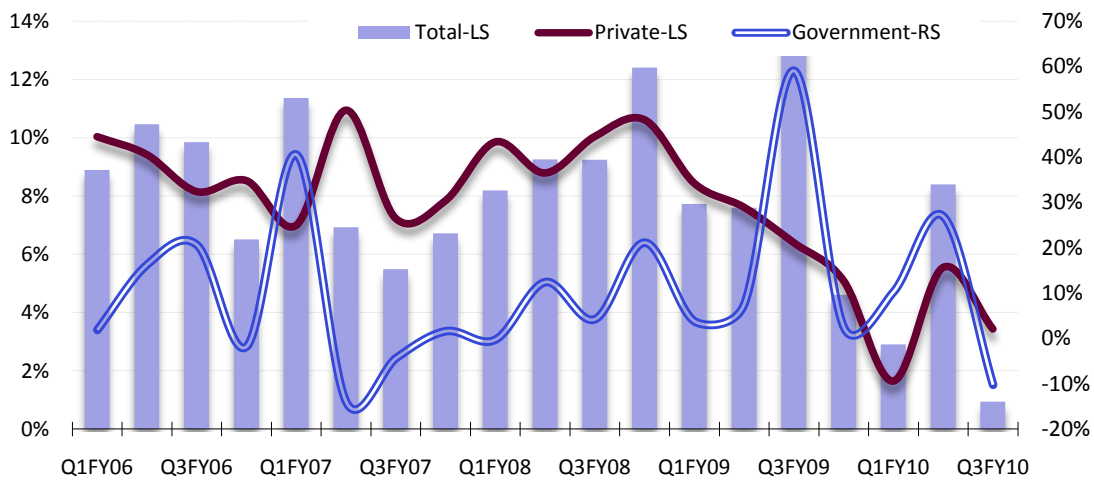
Source: CSO, IMaCS Analysis

Yoy growth in private final consumption expenditure (PFCE) has declined from 10.6% in Q4FY2008 to only 1.7% in Q1FY2010. PFCE increased 5.5% (yoy) in Q2FY2010 and at a lower rate of 3.4% (yoy) in Q3FY2010. The decline reflects seasonal effects as well as uncertain consumer confidence. However,

till Q2FY2010, total final consumption had 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 2.9% 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. However, the 10.3% (yoy) decline in government expenditure in Q3FY2010 resulted in total final consumption expenditure increasing at a sharply lower rate of 0.9% (yoy) in Q3FY2010. The (yoy) decline in government consumption expenditure is attributable to the base effect (increase of 59% in Q3FY2010 and winding down of the stimulus package on the expenditure side).

Yoy Growth in Consumption Expenditure

Percent, at constant prices



Source: CSO, IMAcS Analysis

As can be seen from the table below, manufacturing accounted for 35.1% of incremental real GDP growth in Q3FY2010, which represents a recovery from 1.5% in Q4FY2009. Other sectors that have accounted for higher share of incremental GDP growth in Q3FY2010 vis-a-vis Q2FY2010 include 'construction', 'trade, hotels, transport & communication', and 'financing, insurance, real estate & business services'. By comparison, as noted above, two sectors--'agriculture, forestry and fishing' and 'community, social, and personal services'—dampened real GDP growth in Q3FY2010.

Incremental GDP and Share

	FY2009				FY2010		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Rs. Billion (yoy)							
Agriculture, forestry and fishing	47.42	29.13	-28.95	53.87	36.47	11.25	-57.74
Agriculture	47.42	29.13	-28.95	53.87	36.47	11.25	-57.74
Mining & Quarrying	5.89	3.59	6.88	-0.93	18.36	21.46	24.50
Manufacturing	88.14	83.62	20.80	9.34	53.21	147.94	230.14
Electricity, gas & water supply	6.44	8.38	7.93	8.15	12.57	15.15	9.98
Industry	100.47	95.59	35.61	16.56	84.14	184.55	264.62
Construction	53.16	61.25	23.86	46.56	57.10	53.18	71.67
Trade, hotels, transport & communication	252.09	237.82	114.13	157.58	208.77	222.54	272.95
Financing, insurance, real estate & bus. Services	138.70	132.54	163.97	205.94	135.14	130.24	138.02
Community, social & personal services	96.11	124.50	333.45	123.82	80.91	168.26	-33.54
Services	540.06	556.11	635.42	533.89	481.92	574.23	449.10
GDP at Factor Cost	687.95	680.83	642.08	604.32	602.52	770.02	655.97
Share							
Agriculture, forestry and fishing	6.9%	4.3%	-4.5%	8.9%	6.1%	1.5%	-8.8%
Agriculture	6.9%	4.3%	-4.5%	8.9%	6.1%	1.5%	-8.8%
Mining & Quarrying	0.9%	0.5%	1.1%	-0.2%	3.0%	2.8%	3.7%
Manufacturing	12.8%	12.3%	3.2%	1.5%	8.8%	19.2%	35.1%
Electricity, gas & water supply	0.9%	1.2%	1.2%	1.3%	2.1%	2.0%	1.5%
Industry	14.6%	14.0%	5.5%	2.7%	14.0%	24.0%	40.3%
Construction	7.7%	9.0%	3.7%	7.7%	9.5%	6.9%	10.9%
Trade, hotels, transport & communication	36.6%	34.9%	17.8%	26.1%	34.6%	28.9%	41.6%
Financing, insurance, real estate & bus. Services	20.2%	19.5%	25.5%	34.1%	22.4%	16.9%	21.0%
Community, social & personal services	14.0%	18.3%	51.9%	20.5%	13.4%	21.9%	-5.1%
Services	78.5%	81.7%	99.0%	88.3%	80.0%	74.6%	68.5%
GDP at Factor Cost	100%	100%	100%	100%	100%	100%	100%

Source: CSO, IMAcS Analysis

Real GDP Expected to Increase 7.2% in FY2010

On February 8, 2010, the CSO also released the advance estimates of National Income for 2009-10. According to these estimates, real GDP growth is expected to increase from 6.7% in FY2009 to 7.2% in FY2010. The higher growth is primarily attributable to a sharp recovery in manufacturing, which is expected to offset declines or deceleration in agriculture and community, social & personal services. As can be seen from the table below, the recovery in GDP growth for FY2010 is broad-based with seven out of eight sectors/sub-sectors showing a growth rate of 6.5% or higher, compared with three in FY2009. The exception is agriculture and allied sectors where real GDP is expected to decline 0.2% in FY2009.

Advance Estimates of Real GDP and Growth

	Rs. Billion			Growth		
	2008	2009	2010	2008	2009	2010
Agriculture, forestry and fishing	6,403.15	6,504.61	6,493.70	4.7%	1.6%	-0.2%
Agriculture	6,403.15	6,504.61	6,493.70	4.7%	1.6%	-0.2%
Mining & Quarrying	972.01	987.45	1,073.34	3.9%	1.6%	8.7%
Manufacturing	6,294.46	6,496.35	7,075.12	10.3%	3.2%	8.9%
Electricity, gas & water supply	787.76	818.66	885.90	8.5%	3.9%	8.2%
Industry	8,054.23	8,302.46	9,034.36	9.3%	3.1%	8.8%
Construction	3,142.98	3,327.82	3,545.14	10.0%	5.9%	6.5%
Trade, hotels, transport & communication	10,086.03	10,847.64	11,743.20	10.7%	7.6%	8.3%
Financing, insurance, real estate & bus. Services	6,372.23	7,013.38	7,704.43	13.2%	10.1%	9.9%
Community, social & personal services	4,875.95	5,553.82	6,009.80	6.7%	13.9%	8.2%
Services	24,477.19	26,742.66	29,002.57	10.4%	9.3%	8.5%
GDP at Factor Cost	38,934.57	41,549.73	44,530.64	9.2%	6.7%	7.2%

Source: CSO, IMAcS Analysis

AGRICULTURAL PRODUCTION

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.

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.

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%

Source: Ministry of Agriculture, IMAcS Analysis

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 was expected to decline 17.9% (or by 21.1 mt) to 96.63 mt. The Second Advance Estimates released on February 12, 2010 caused an upward revision to 99.85 mt, which 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	84.91	72.87	3.1%	2.7%	-14.2%
Coarse Cereals	31.89	28.54	22.76	24.5%	-10.5%	-20.3%
Pulses	6.40	4.69	4.21	33.3%	-26.7%	-10.2%
Food grains	120.95	118.14	99.84	9.4%	-2.3%	-15.5%
Oilseeds	20.71	17.81	16.19	47.8%	-14.0%	-9.1%
Cotton	4.40	3.79	3.79	14.4%	-13.9%	0.2%
Jute & Mesta	2.02	1.87	1.86	-0.5%	-7.5%	-0.1%
Sugarcane	348.2	285.0	251.3	-2.1%	-18.1%	-11.8%

Source: Ministry of Agriculture, IMaCS Analysis

Prospects for rabi 2009-10 crop remained promising initially 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 31, 2009 was 8% above normal, with weakness in the latter period. By comparison, precipitation was 31% below normal in the corresponding previous (October 1 to December 31, 2008). This is a positive development that is likely to partially offset the impact of drought in the current year via supporting overall crop production through improved Rabi production. The spatial distribution of rainfall reveals that of the 36 meteorological sub-divisions, cumulative rainfall was excess/normal in 23 subdivisions.

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

October 1 to December 31

	Rainfall (mm)			Percent Departure from Normal	
	Normal	Actual (2009)	Actual (2008)	2009	2008
Country as a whole	125.9	135.5	87.2	7.6%	-30.7%
Northwest India	66.7	52.9	44.6	-20.7%	-33.1%
Central India	79.9	120.3	25.3	50.6%	-68.3%
South Peninsula	268.4	294.8	257.0	9.8%	-4.2%
North East India	161.5	130.8	90.9	-19.0%	-43.7%
South Peninsula					
Coastal Andhra Pradesh	326.2	261.6	262.1	-19.8%	-19.7%
Telangana	109.6	128.2	42.9	17.0%	-60.9%
Rayalaseema	212.1	210.3	251.9	-0.8%	18.8%
Tamil Nadu & Pondicherry	431.8	482.7	563.6	11.8%	30.5%
Coastal Karnataka	258.0	430.5	124.5	66.9%	-51.7%
North Interior Karnataka	136.7	286.4	100.0	109.5%	-26.8%
South Interior Karnataka	199.7	202.8	145.2	1.6%	-27.3%
Kerala	498.5	529.3	427.0	6.2%	-14.3%
Lakshadweep	328.9	388.3	450.6	18.1%	37.0%

Source: IMD

State of the Economy

Modest Increase in Rabi Production, but Overall Food grain Production to Decline 7.5% in 2009-10

Data on progress of rabi sowing till February 19, 2010 indicate higher sowing for wheat and pulses; but declines for coarse cereals and oilseeds.

Area Coverage under Rabi Crops

Thousand hectares, Up to February 12

	2008-09	2009-10	Change
Wheat	27,589	27,814	0.8%
Rice	3,659	3,492	-4.6%
Coarse Cereals	6,830	6,466	-5.3%
Pulses	13,275	14,088	6.1%
Oilseeds	9,544	9,177	-3.9%

Source: Ministry of Agriculture

The excess rainfall received during the rabi season is expected to partially compensate for the shortfall in crop production during Kharif 2009. The Second Advance Estimates released on February 12, 2010 have forecast a 0.6% increase in rabi food grain production to 117 mt, attributable mainly to a 0.5% decline in wheat production. Although rainfall has been above normal, prospects for the harvests are uncertain due to prolonged dry spells and erratic rainfall since the beginning of the season. The drought may adversely affect yields in non-irrigated areas and may have reduced water reserves available for irrigation. Oilseeds production growth is expected at 2.2% in rabi 2009-10, compared with an increase of 9.6% in 2008-09.

Rabi Agricultural Production

	Mt			Growth		
	2008	2009	2010	2008	2009	2010
Rice	14.03	14.27	14.69	6.4%	1.7%	2.9%
Wheat	78.57	80.68	80.28	3.6%	2.7%	-0.5%
Coarse Cereals	8.87	11.49	11.50	6.7%	29.5%	0.1%
Pulses	8.36	9.88	10.53	-11.1%	18.2%	6.6%
Food grains	109.83	116.32	117.00	2.9%	5.9%	0.6%
Oilseeds	9.04	9.91	10.13	-12.0%	9.6%	2.2%

Source: Ministry of Agriculture, IMaCS Analysis

The Ministry of Agriculture has set the target for food grains production for FY2010 at 239.10 mt, compared with actual achievement of 234.5 mt in 2008-09. However, as per the Second Advance Estimates for 2009-10, the total food grains production during 2009-10 is placed at 216.9 mt, representing a decline of 7.5%. In absolute terms, this represents a likely achievement of 22 mt below targeted production, and 17.6 mt below the actual production for 2008-09. There has been a decline in the production of rice, wheat, oilseeds, and cotton.

Agricultural Production

	Mt				Growth		
	2008	2009	2010	2010 (Target)	2008	2009	2010
Rice	96.69	99.18	87.56	100.50	3.6%	2.6%	-11.7%
Wheat	78.57	80.68	80.28	79.00	3.6%	2.7%	-0.5%
Coarse Cereals	40.76	40.03	34.27	43.10	20.2%	-1.8%	-14.4%
Cereals	216.02	219.90	202.11	222.60	6.4%	1.8%	-8.1%
Pulses	14.76	14.57	14.74	16.50	3.9%	-1.3%	1.2%
Total Food grains	230.78	234.47	216.85	239.10	6.2%	1.6%	-7.5%
<i>Kharif</i>	<i>120.95</i>	<i>118.14</i>	<i>99.85</i>	<i>125.15</i>	<i>9.4%</i>	<i>-2.3%</i>	<i>-15.5%</i>
<i>Rabi</i>	<i>109.83</i>	<i>116.33</i>	<i>117.00</i>	<i>113.95</i>	<i>2.9%</i>	<i>5.9%</i>	<i>0.6%</i>
Total Nine Oilseeds	29.76	27.72	26.32	31.60	22.5%	-6.8%	-5.0%
Cotton	4.40	3.79	3.79	14.4%	-13.9%	0.2%	4.40
Jute & Mesta	2.02	1.87	1.86	-0.5%	-7.5%	-0.1%	2.02
Sugarcane	348.2	285.0	251.3	-2.1%	-18.1%	-11.8%	3,48.2

Source: Ministry of Agriculture, IMaCS Analysis

INDUSTRIAL PRODUCTION

Recent Moderate Recovery in Global Industrial Production

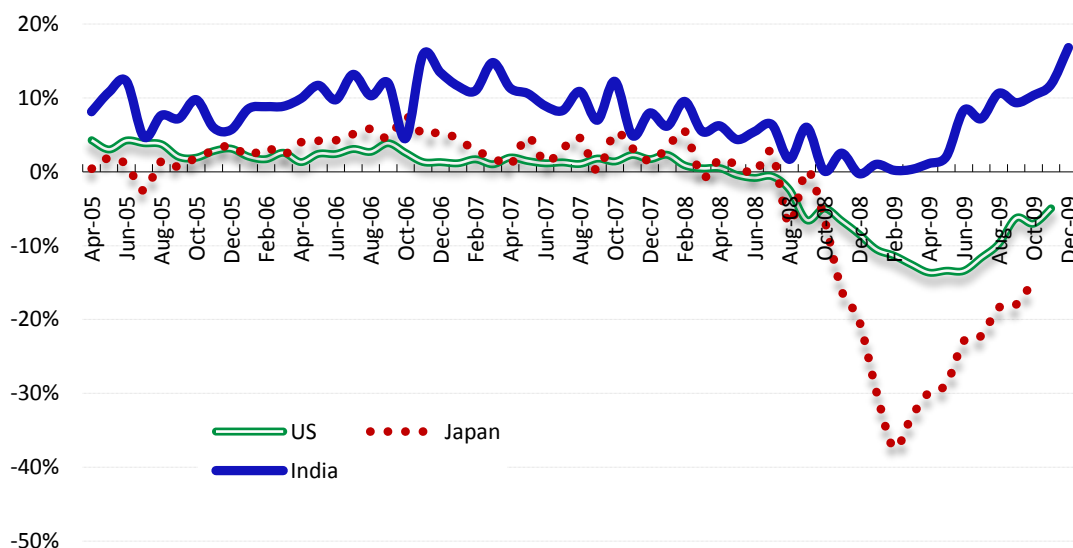
Following the financial crisis in September 2008, world industrial production, trade, and employment had dropped sharply. Industrial production and merchandise trade plummeted in the fourth quarter of 2008 and continued to fall rapidly in early 2009 across both advanced and emerging economies, as purchases 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 in 2009 has gained momentum through 2009. 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 2010, the rate should decline, thereby boosting growth. After a recent increase, The Purchasing Manager's Index (PMI) of the Institute of Supply Management (ISM) accelerated to 54.8% in January 2010, an increase of 3.5 percentage points when compared with

State of the Economy

December 2009 seasonally adjusted reading of 54.9%. This represents the sixth consecutive month of growth in the manufacturing sector, and the highest reading for the Index since August 2004 when it registered 58.5%. Prior to this recent growth trend, the PMI declined for 13 consecutive months. 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 65.9% in January 2010, compared with the seasonally adjusted 64.8% registered in December 2009. This is the seventh consecutive month of growth in the New Orders Index. A New Orders Index above 50.2% is generally consistent with an increase in the Census Bureau's series on manufacturing orders (in constant 2000 dollars).

YoY Growth in Industrial Production

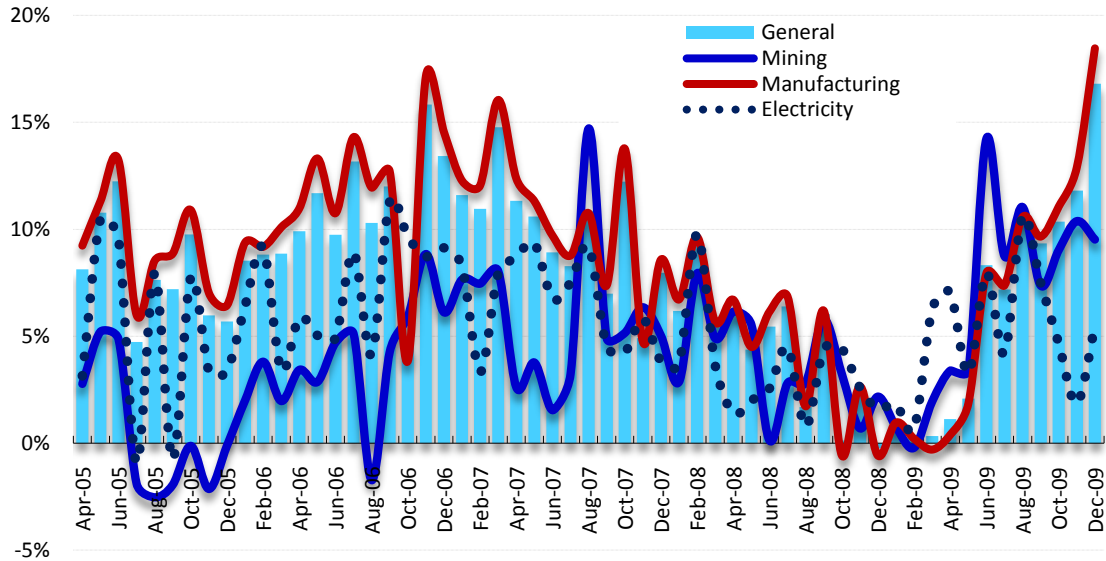


Source: IMF, IMAcS Analysis

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

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 during August-December 2009. Overall, the IIP increased 13.1% (yoy) in Q3FY2010, compared with 9% (yoy) in Q2FY2010, and 0.8% (yoy) in Q3FY2010. 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	Q4	Q1	Q2	Q3	Nov	Dec
	FY2009	FY2009	FY2010	FY2010	FY2010	2009	2009
Food Products	0.6	-25.2	-17.2	-5.2	-0.6	6.9	-6.9
Beverages, Tobacco and Related Products	12.2	12.5	-6.2	2.1	0.7	2.0	0.5
Cotton Textiles	-3.5	-4.3	-1.7	4.3	7.5	8.8	2.6
Wool, Silk and man-made fibre textiles	1.3	0.5	4.8	21.2	11.7	12.3	3.8
Jute and other vegetable fibre Textiles (except cotton)	-23.2	-6.3	-16.2	-18.3	-10.4	-18.2	24.5
Textile Products (including Wearing Apparel)	3.8	8.7	8.2	11.0	10.2	4.6	10.2
Wood and Wood Products; Furniture and Fixtures	-10.0	-16.3	14.7	1.3	11.0	3.4	10.4
Paper & Paper Products and Printing, Publishing & Allied Industries	1.3	-2.8	3.6	-0.5	3.8	7.3	4.0
Leather and Leather & Fur Products	-10.5	-13.0	-3.5	4.8	1.1	-4.5	-0.1
Basic Chemicals & Chemical Products (except products of Petroleum & Coal)	-4.6	8.8	2.0	13.8	21.8	17.8	29.0
Rubber, Plastic, Petroleum and Coal Products	-0.9	2.7	10.6	14.3	18.4	19.1	21.5
Non-Metallic Mineral Products	1.9	1.7	8.3	4.9	6.3	6.8	8.2
Basic Metal and Alloy Industries	5.0	-2.0	7.7	2.6	3.4	4.1	5.8
Metal Products and Parts, except Machinery and Equipment	-0.4	-16.8	-4.8	4.9	15.6	27.8	11.7
Machinery and Equipment other than Transport equipment	4.7	10.3	7.2	15.0	24.8	12.6	44.6
Transport Equipment and Parts	-10.9	-1.5	6.9	12.0	43.6	38.5	82.2
Other Manufacturing Industries	5.6	-2.7	14.9	12.3	1.6	19.8	-9.4
Mining	2.0	0.9	6.8	9.0	9.6	10.4	9.5
Manufacturing	0.5	0.3	3.4	9.2	14.3	12.9	18.5
Electricity	2.9	3.0	6.0	7.4	4.0	1.8	5.4
General	0.8	0.5	3.8	9.0	13.1	11.8	16.8

Source: CSO, IMAcS Analysis

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)

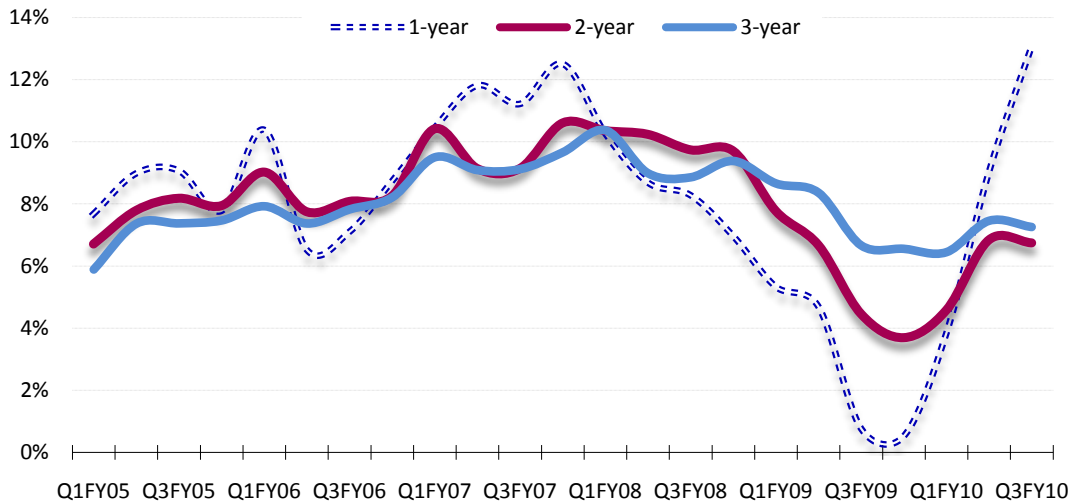
(yoy)

	Q3 FY2009	Q4 FY2009	Q1 FY2010	Q2 FY2010	Q3 FY2010	Nov 2009	Dec 2009
Basic	2.4	0.4	6.3	5.9	5.9	5.7	7.5
Capital	3.8	5.0	2.0	8.6	21.6	11.8	38.8
Intermediate	-5.8	-2.7	7.4	11.7	18.7	19.1	21.7
Total	3.3	1.2	-0.5	10.1	11.9	11.9	12.0
Consumer Durables	-1.8	5.6	15.6	23.7	33.8	38.4	46.0
Consumer Non Durables	4.9	-0.1	-5.3	5.1	5.2	4.0	3.7
General	0.8	0.5	3.8	9.0	13.1	11.8	16.8

Source: CSO, IMAcS Analysis

Although IIP growth has been substantially higher, this is partly attributable to the base effect as IIP growth had started to plunge during Q2FY2010. On a 2-year basis, IIP growth was 6.8% (yoy) in Q2FY2010, and 6.7% (yoy) in Q3FY2010. In many industries, the recent growth rates (on a 2-year basis) are significantly lower than those achieved till 2007-08.

Yoy Growth in IIP



Source: GoI, IMAcS analysis

Growth of Manufacturing Groups (2-digit)

percent

	Q2 FY2010		Q3 FY2010	
	1-year	2-year	1-year	2-year
General Index	9.0	6.8	13.1	6.7
2-digit based				
Food Products	-5.2	1.0	-0.6	0.0
Beverages, Tobacco and Related Products	2.1	5.9	0.7	6.3
Cotton Textiles	4.3	0.5	7.5	1.9
Wool, Silk and man-made fibre textiles	21.2	5.1	11.7	6.4
Jute and other vegetable fibre Textiles (except cotton)	-18.3	-10.9	-10.4	-17.1
Textile Products (including Wearing Apparel)	11.0	7.4	10.2	6.9
Wood and Wood Products; Furniture and Fixtures	1.3	0.4	11.0	0.0
Paper & Paper Products and Printing, Publishing & Allied Industries	-0.5	3.5	3.8	2.5
Leather and Leather & Fur Products	4.8	-2.2	1.1	-4.9
Basic Chemicals & Chemical Products (except products of Petroleum & Coal)	13.8	7.3	21.8	7.8
Rubber, Plastic, Petroleum and Coal Products	14.3	4.5	18.4	8.3
Non-Metallic Mineral Products	4.9	2.5	6.3	4.0
Basic Metal and Alloy Industries	2.6	5.5	3.4	4.2
Metal Products and Parts, except Machinery and Equipment	4.9	3.3	15.6	7.3
Machinery and Equipment other than Transport equipment	15.0	13.6	24.8	14.3
Transport Equipment and Parts	12.0	13.0	43.6	13.1
Other Manufacturing Industries	12.3	9.4	1.6	3.6
Mining	9.0	6.4	9.6	5.8
Manufacturing	9.2	7.0	14.3	7.1
Electricity	7.4	5.3	4.0	3.4
Use-based				
Basic	5.9	5.3	5.9	4.2
Capital	8.6	10.8	21.6	12.3
Intermediate	11.7	4.8	18.7	5.7
Total	10.1	8.3	11.9	7.5
Consumer Durables	23.7	17.0	33.8	14.6
Consumer Non Durables	5.1	5.1	5.2	5.1

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.

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.

According to a recent report by United Nations Conference on Trade and Development (UNCTAD), global inflows of foreign direct investment (FDI) declined 38.7% in 2009 to US\$1.04 billion. This represents the second successive year of decline, with FDI inflows declining 14.2% in 2008. The decline in FDI during 2009 was widespread across all major groups of economies. After experiencing a decline of 29.2% in 2008, FDI flows to developed countries continued their dramatic decline in 2009. FDI flows to developing and transition economies, which had risen in 2008, declined in 2009 (by 34.7% and 39.4%, respectively).

World FDI Inflows

	US\$ billion			Growth		
	2007	2008	2009	2007	2008	2009
Developed economies	1,358.6	962.3	565.6	39.7%	-29.2%	-41.2%
EU	842.3	503.5	356.7	42.7%	-40.2%	-29.2%
Japan	22.5	24.4	11.4	-446.2%	8.4%	-53.3%
US	271.2	316.1	135.9	14.4%	16.6%	-57.0%
Developing economies	529.3	620.7	405.5	22.0%	17.3%	-34.7%
Africa	69.2	87.6	55.9	21.2%	26.6%	-36.2%
Latin America and the Caribbean	127.5	144.4	85.5	36.7%	13.3%	-40.8%
Asia and Oceania	332.7	388.7	264.1	17.4%	16.8%	-32.1%
China	83.5	92.4	90.0	14.9%	10.7%	-2.6%
India	25.1	41.6	33.6	23.6%	65.4%	-19.1%
South-East Europe & CIS	90.9	114.4	69.3	66.5%	25.9%	-39.4%
World	1,978.8	1,697.4	1,040.3	35.4%	-14.2%	-38.7%

Source: UNCTAD, IMAcS Analysis

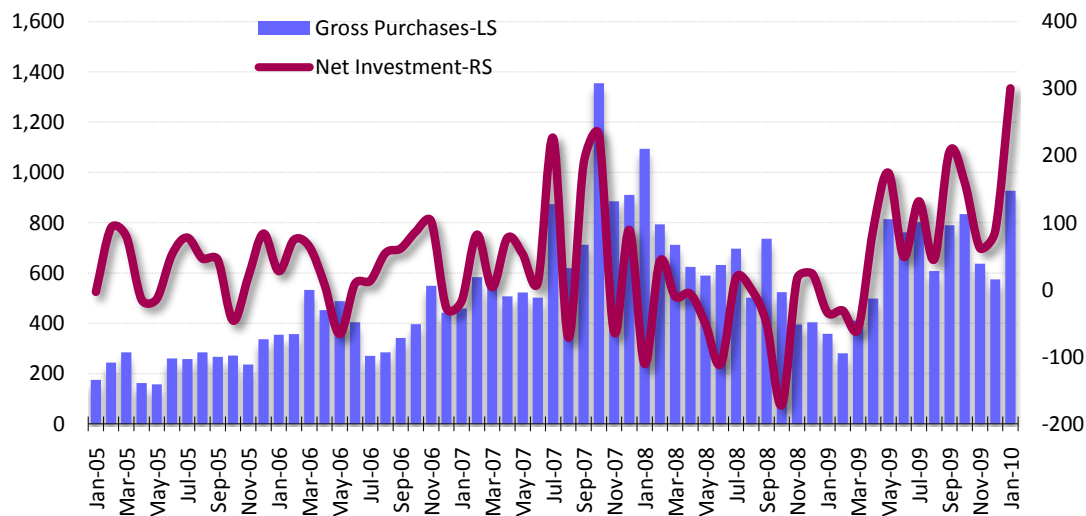
During 2009, after a sharp decline in 1Q2009, followed by a slight rebound in 2Q2009, FDI flows in 3Q2009 remained relatively stable. Initial indicators for 4Q2009 show no signs of a pick-up in FDI

flows. Nevertheless, it is still that a modest rebound in flows will take place in 2010, attributable to an improvement in investment conditions in many countries.

According to the data released by the SEBI, FIIs have made net purchases of Rs. 1,304.67 billion in the Indian market during 10MFY2010 (April 2009-January 2010) as compared with net sales of Rs. 367.96 billion during 10MFY2009. 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 57% during April-December 2009. On a calendar year basis, the BSE Sensex and NSE Index increased 93% and 95%, respectively during 2009.

Investment by FIIs

Rs. billion



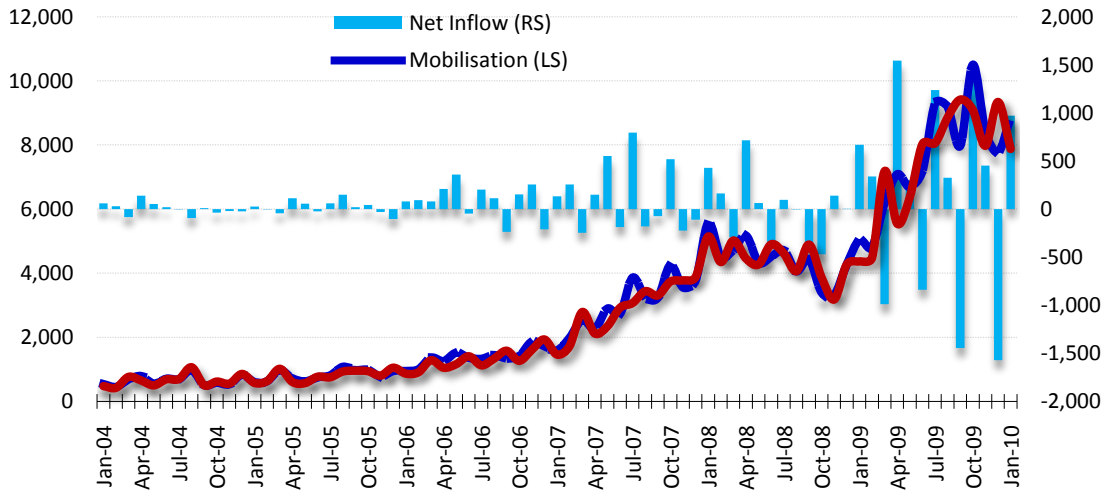
Source: SEBI, ImaCS Analysis

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. 2,389 billion in 10MFY2010 (April 2009-January 2010), compared with net inflows of Rs. 21.35 billion in Q4FY2009, and net outflows of Rs. 329.09 billion in Q3FY2009. MFs experienced substantially higher redemptions in December 2009, even as inflows declined. However, this trend was reversed in January 2009 resulting in MFs reporting net inflows of Rs. 972.42 billion in January 2010.

State of the Economy

Investment in Domestic MFs

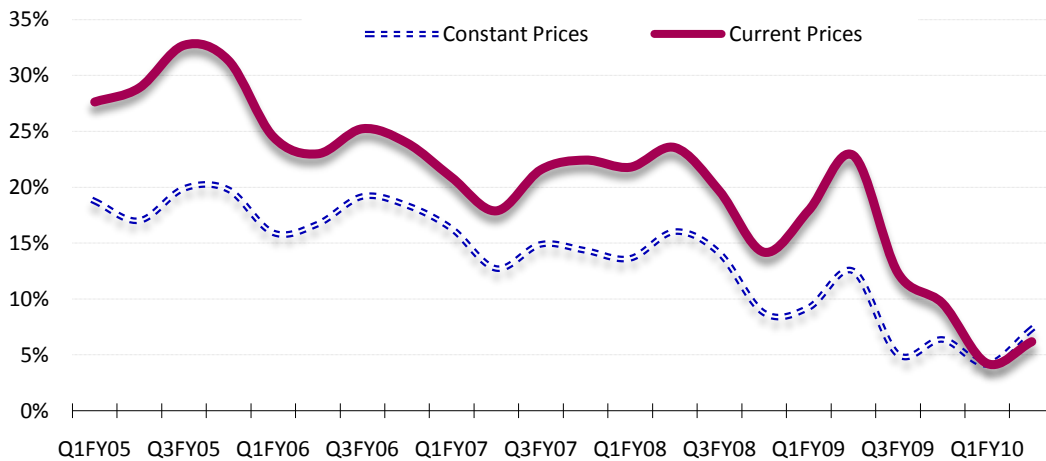
Rs. billion



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

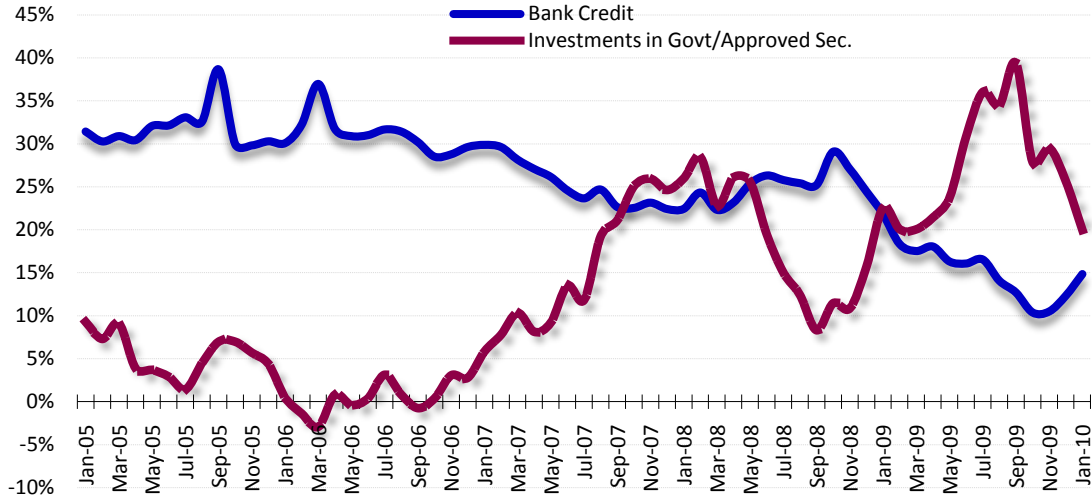
Beginning from mid-September 2008, the Indian financial markets came under severe pressure owing to the knock-on effects of the global crisis. The contagion was initially felt in the equity markets due to the reversal of foreign institutional portfolio flows. With sharp tightening of global liquidity, 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 10.4% (yoy) in October 2009. Growth has again increased to 14.8% (yoy) in January 2010, with much of the incremental growth attributable to the base effect. In absolute terms, credit increased Rs. 1,544.09 billion during October 2009-January 2010, compared with Rs. 867.55 billion during the corresponding previous. Bank credit to Government has however grown at a high (but declining) 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 29.9% on January 15, 2010, compared with 28.1% at end-March 2009, and 28.8% a year-ago. Excess SLR investments of SCBs increased from Rs. 1,698.46 billion at end-March 2009 to Rs. 2,267.20 billion on January 15, 2010.

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

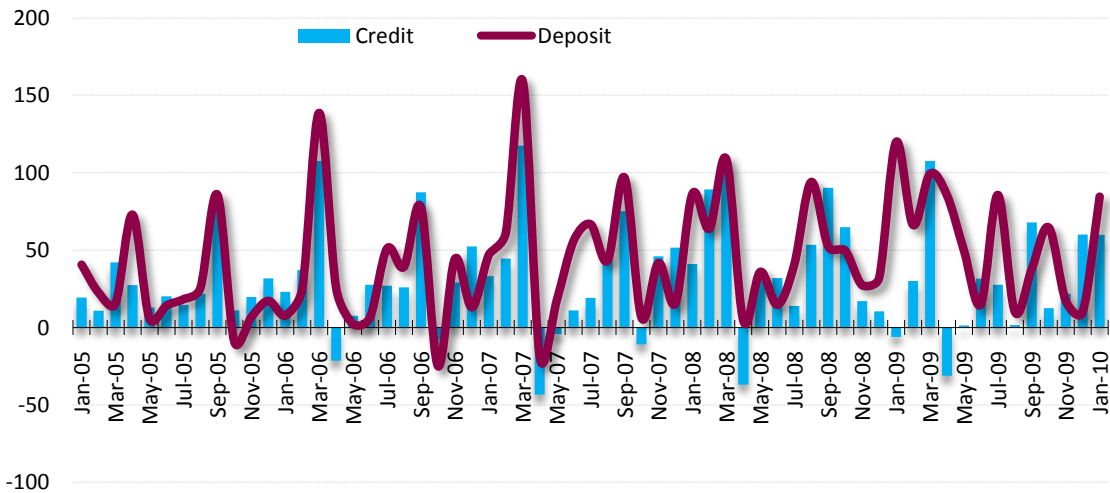


Source: RBI, IMAcS analysis

Although credit growth has decelerated sharply, deposit growth has also 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 70.5 at end-January 2010. 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

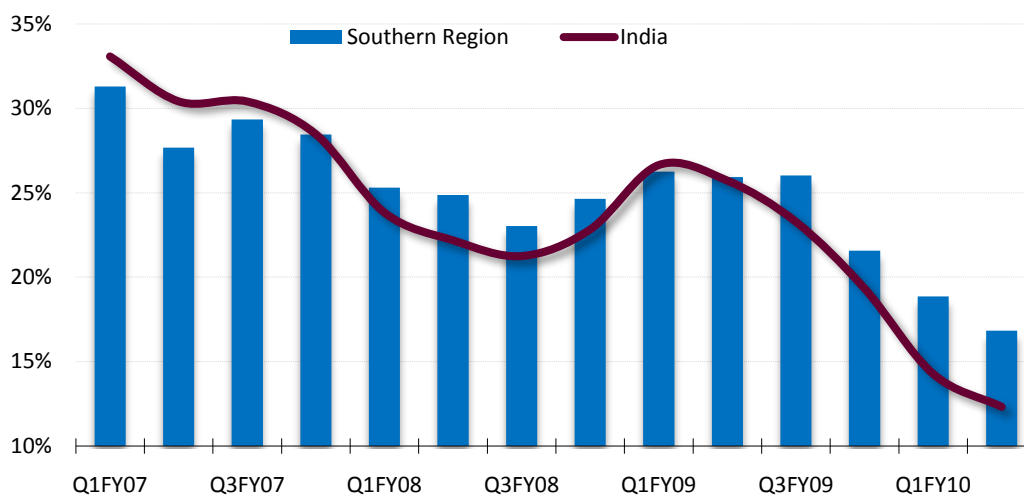
Southern Region Growth in Credit and Deposits

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 September 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, and to 12.3% (yoy) at end-September 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 16.8% (yoy) in July-September 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	Q4	Q1	Q2	Q3	Q4	Q1	Q2
	FY2009	FY2009	FY2010	FY2010	FY2009	FY2009	FY2010	FY2010
Deposits								
SOUTHERN								
REGION	7,811	8,623	8,567	8,910	22.3%	22.8%	19.1%	18.8%
AP	1,956	2,175	2,129	2,217	24.3%	22.5%	16.9%	17.0%
Karnataka	2,336	2,567	2,576	2,675	20.8%	22.0%	20.9%	19.4%
Kerala	1,225	1,352	1,358	1,406	20.7%	23.9%	21.0%	21.8%
TN	2,241	2,470	2,444	2,550	23.3%	23.5%	18.0%	18.1%
Lakshadweep	4	5	5	4	38.9%	47.2%	45.5%	24.0%
Puducherry	49	55	55	57	10.6%	15.9%	18.0%	20.0%
ALL-INDIA	35,573	39,373	39,653	41,015	21.0%	21.9%	21.1%	19.8%
Credit								
SOUTHERN								
REGION	7,101	7,623	7,613	7,923	26.0%	21.6%	18.9%	16.8%
AP	1,955	2,122	2,133	2,245	35.5%	30.5%	27.4%	24.8%
Karnataka	1,809	1,967	1,938	1,963	21.6%	19.9%	16.0%	12.2%
Kerala	778	816	813	856	17.6%	14.6%	12.8%	13.6%
TN	2,531	2,690	2,701	2,828	25.3%	18.6%	16.6%	15.3%
Lakshadweep	0	0	0	0	0.0%	4.0%	8.3%	33.3%
Puducherry	26	28	29	30	25.7%	21.8%	19.3%	19.9%
ALL-INDIA	26,595	28,575	27,884	28,819	23.3%	19.3%	14.3%	12.3%

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. Tightening of bank lending standards has moderated, and most banks in major markets are now less reliant on central bank emergency facilities and government guarantees. 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 through 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 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

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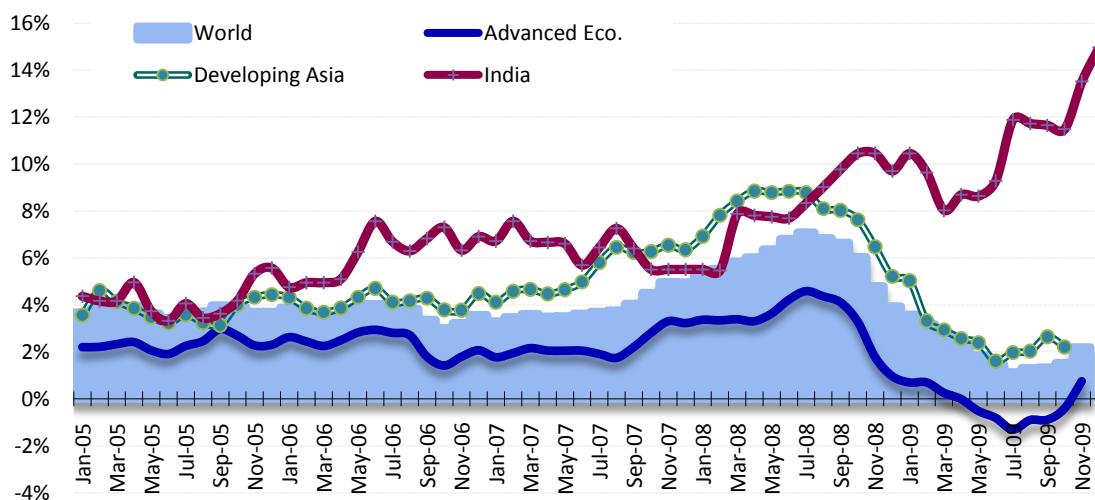
credit losses, especially as a result of the economic downturn that is putting upward pressure on default rates across the various types of loans, in particular real estate. Moreover, bank capital will also have to be raised to levels that help rebuild confidence in the sector and are consistent with emerging regulatory

INFLATIONARY CONDITIONS

Recent Rebound in Global Prices and Inflation

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 2.2% in November 2009. Deflationary pressures have subsided in the advanced economies, with CPI increasing 0.7% (yoy) in November 2009, following six months of negative growth.

World CPI

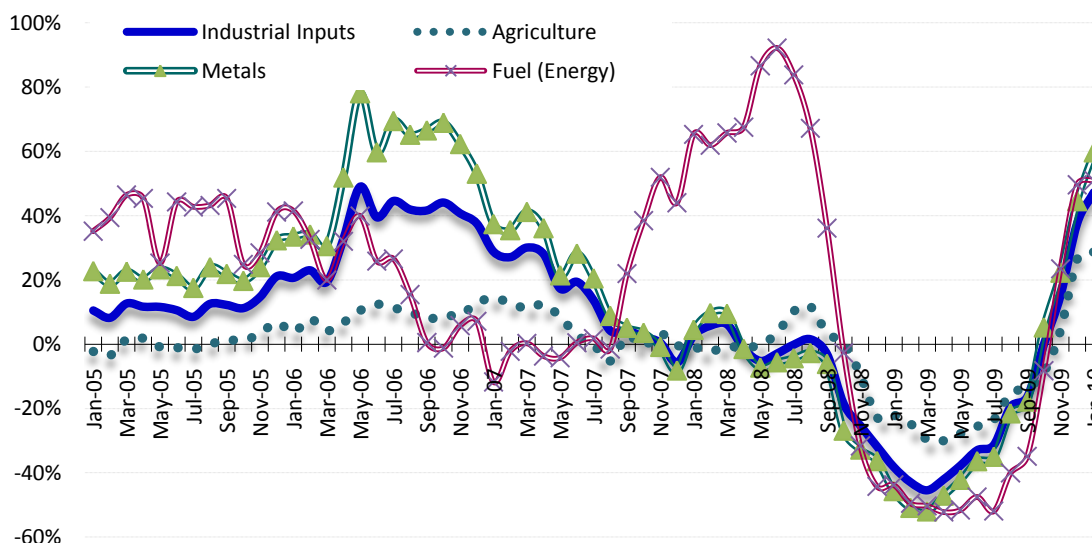


Source: IMF, IMAcS Analysis

Till mid-2009, inflation pressures had subsided, as output gaps widened and food and fuel prices dropped. The sharp decline in inflation was also driven by a sharp (yoy) decline in commodity prices, and weakening demand prospects. However, commodity prices have risen strongly during the course of 2009, inspite of weak demand prospects and generally high inventories. As in the past, this has been due to the buoyant recovery in emerging Asia and to the improvement in global financial conditions. For 2010, commodity prices are expected to rise further supported by the strength of global demand, especially from emerging economies.

Growth in World Commodity Prices

yoy



Source: IMF, IMAcS Analysis

Short-Term Outlook

While oil prices in January 2010 of US\$77/barrel (bbl) are around 42% below their July 2008 peak they have significantly rebounded in recent months, with the average prices increasing 76% (yoy) during January 2010. 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 January 2010 update of the *World Economic Outlook*, the IMF has forecast oil prices to increase 23% in 2010 to US\$82/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.

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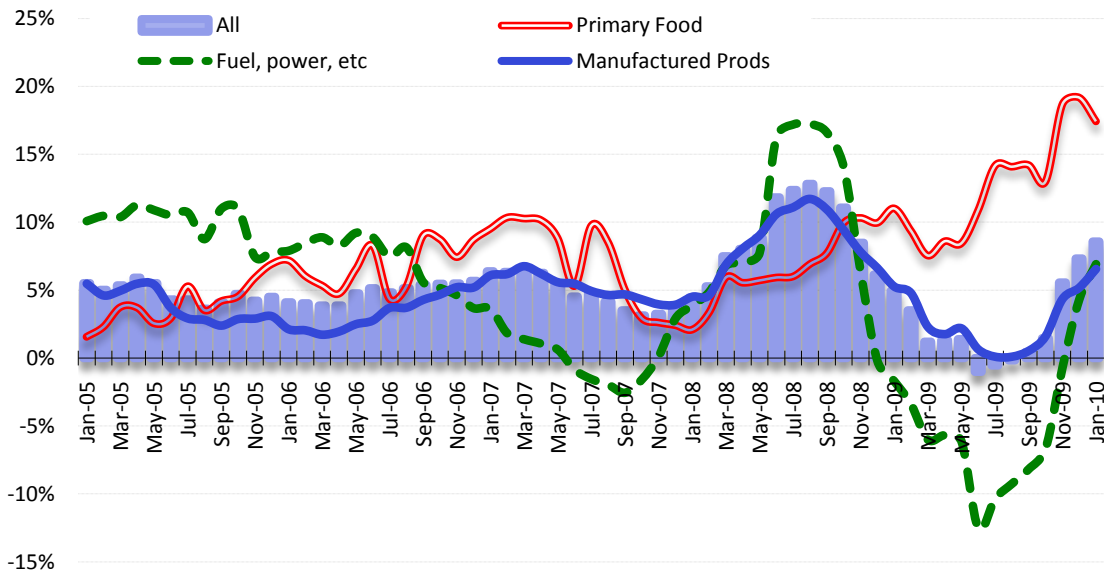
Prices for all important industrial metals have bottomed out and most of them have posted strong gains over recent months. Again, this recovery is in part attributable to rising Chinese imports. Food prices have rebounded as well, reflecting strong Chinese and Indian import demand, weather concerns and 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 6.25% 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 1.25% 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 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 12.8% in August 2008 to -1% in June 2009, before increasing substantially to 8.56% in January 2010. The WPI for food articles has remained high and in fact for many items already exceeds decadal peaks. This is attributable to the continued 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 2006-07, and were magnified by the 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.

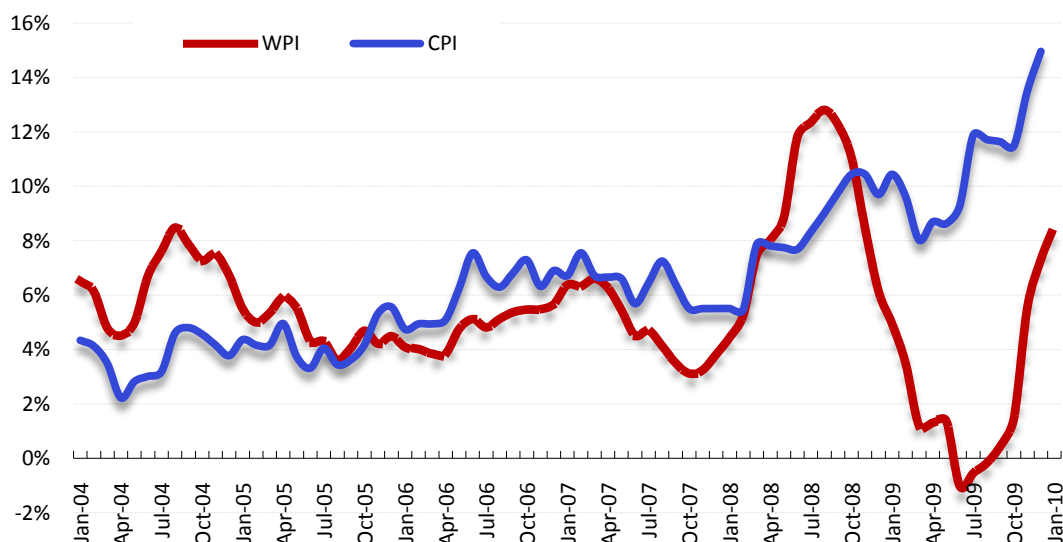
Yoy Growth in WPI



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 in 2008, have still remained high with an increase from mid-2009. 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

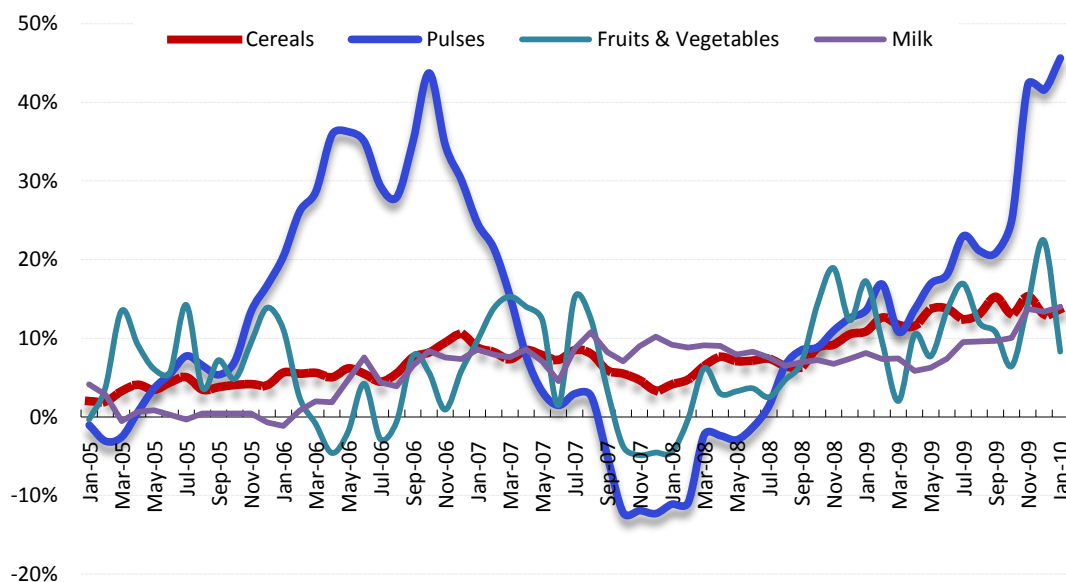


Source: Gol, IMAcS Analysis

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.

With regard to primary food articles, latest indications continue to an improvement in the overall domestic and global cereal supply and demand situation in the 2009-10 marketing season. The Food and Agricultural Organisation (FAO) estimate of world cereal production in 2009 has been raised further and total cereal inventories by the end of the current season are now expected to climb to an 8-year high. However, in spite of these positive developments, international prices of major cereals have continued to decline only very modestly, and rice prices have even increased during 4Q2009. Prices of rice have been increasing in India since the second half of 2008 and are above their levels of a year ago. Prices of wheat have also been rising in recent months in spite of relatively good production gathered in early 2009, possibly reflecting concerns over the uncertainty of the anticipated 2009-10 rabi harvest. Domestic and world cereal prices continue to be firm because of the uncertain outlook for the 2009-10 crop season. While wheat output could decline 0.1% in 2009-10 as a result of adverse weather which could bring down production after two bumper years, early indications point to larger maize crops in some major producing countries. As for rice, a return to a normal monsoon pattern would likely sustain a recovery of global production in 2010 after erratic rains hampered 2009 crops in some countries.

India—Yoy Growth in WPI for Some Primary Food Articles



Source: Gol, IMAcS Analysis

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 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.

TRADE TRENDS

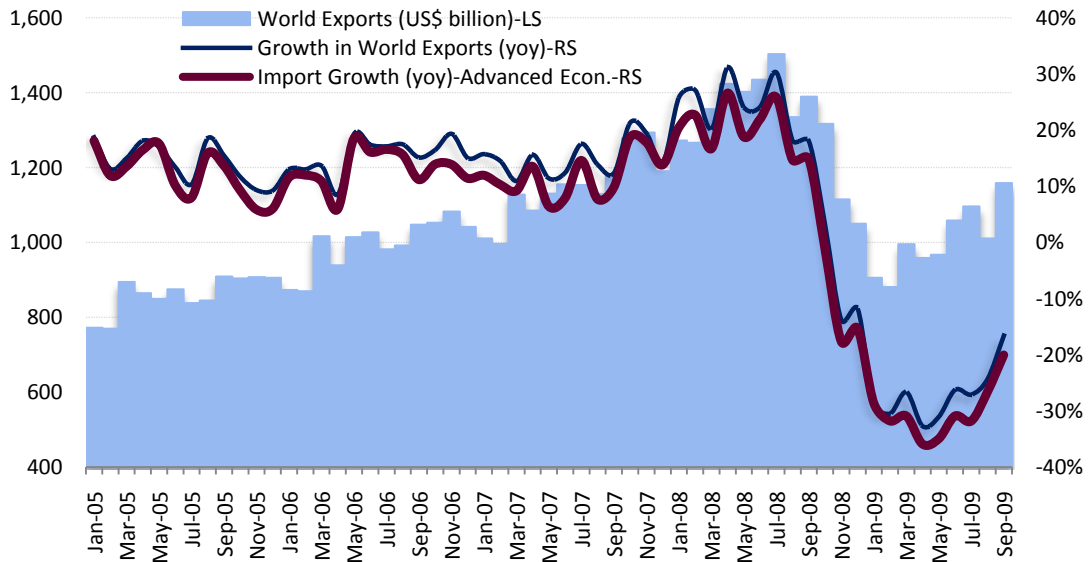
Sharp Contraction in World Trade since late-2008, but recent stabilisation

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

State of the Economy

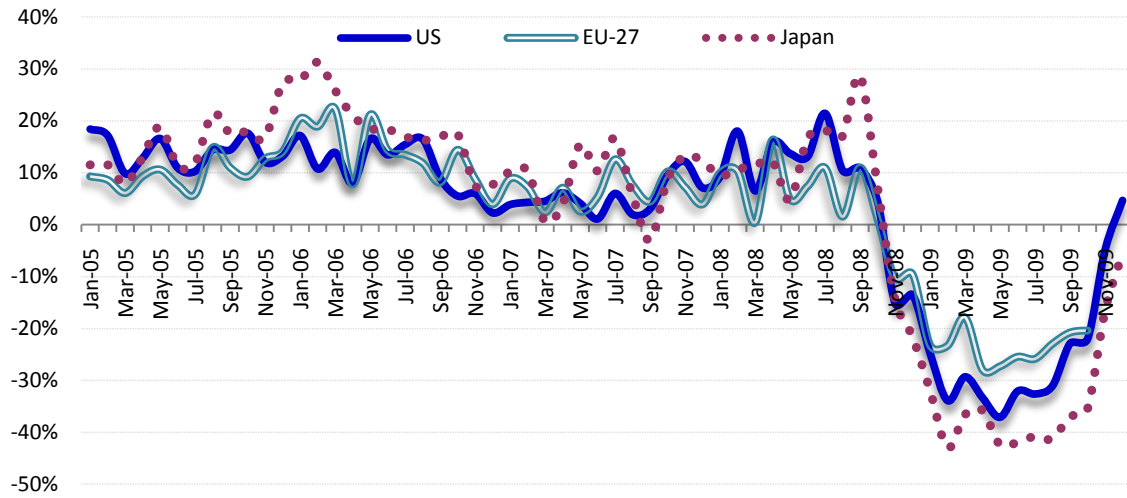
shrinkage in credit to finance trade. Overall world exports increased 15.7% in 2008, compared with 14.1% in 2007, primarily because of the higher export growth recorded in the first half of 2008. Imports by advanced economies increased 18.7% (yoy) in 3Q2008 but contracted by 11% (yoy) in 4Q2008, 33% (yoy) in 1H2009, and 20.8% (yoy) in 2Q2009 reflecting the impact of well entrenched recession. In US\$ dollar terms, imports by advanced economies in 3Q2009 were lower by US\$545 billion compared with 3Q2008. 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. 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 22% (yoy) in 1H2009 and 20% (yoy) in 3Q2009.

World—Monthly Merchandise Export Growth



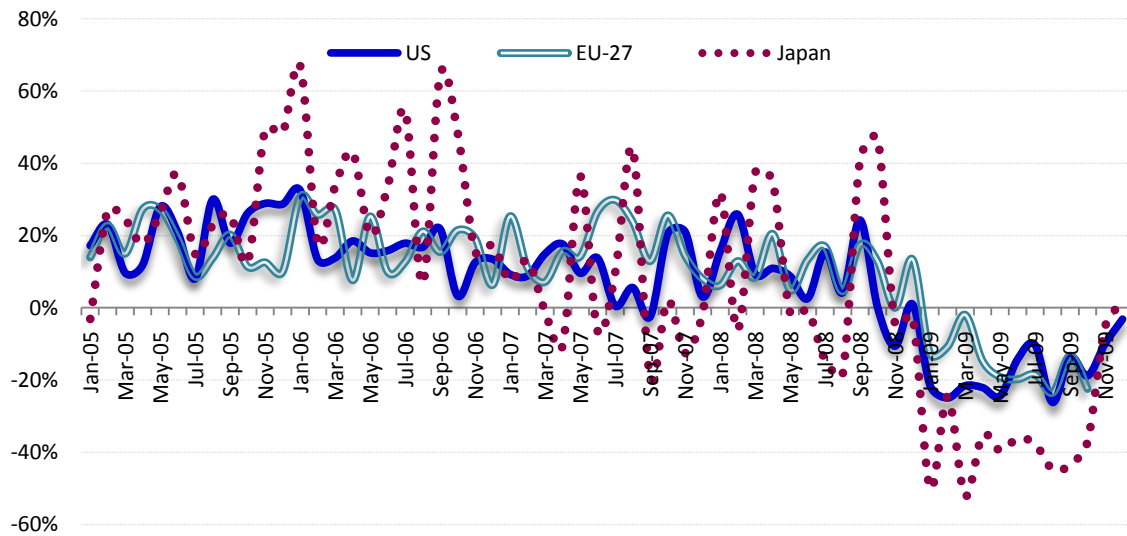
Source: IMF, IMaCS Analysis

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, the IMF has estimated world real GDP growth to have slowed down from 5.2% in 2007 to 3% in 2008, with an expected decline of 0.8% in 2009. However, the global recovery has widened through 2009 across various regions with varying speeds. As a result, in January 2010, the IMF forecast world output to expand 3.9% in 2010, which represents an upward revision from 3.1% growth forecast for 2010 in its October 2009 World Economic Outlook (WEO). In most advanced economies, the recovery is expected to remain sluggish by past standards,

whereas in many emerging and developing economies, activity is expected to be relatively vigorous, largely driven by buoyant internal demand. While output growth in emerging/developing countries is estimated to increase from 2.1% in 2009 to 6% in 2010 (down from 6% in 2008, and 8.3% in 2007), output in advanced economies is expected to decline 3.2% in 2009 but increase 2.1% in 2010 (compared with growth of 0.5% in 2008, and 2.7% in 2007). International trade has decelerated sharply in 2008 and 2009.

Within both groups, growth performance is expected to vary considerably across countries and regions. The key emerging economies in Asia—China, India, and ASEAN-5—are leading the global recovery. However, a few advanced European economies and a number of economies in central and eastern Europe and the Commonwealth of Independent States (CIS) are lagging behind. The rebound of commodity prices is helping support growth in commodity producers in all regions in general, and for the Middle East and Latin American economies in particular.

Growth Projections for Major Economies and Regions

Real GDP Growth, percent

	October 2009 WEO			January 2010 WEO Update		
	2009	2010	2011	2009	2010	2011
Regions						
World	-1.1	3.1	4.2	-0.8	3.9	4.3
Advanced economies	-3.4	1.3	2.5	-3.2	2.1	2.4
EU	-4.2	0.5	1.8	-4.0	1.0	1.9
Emerging and developing economies	1.7	5.1	6.1	2.1	6.0	6.3
Developing Asia	6.2	7.3	8.1	6.5	8.4	8.4
Countries						
China	8.5	9.0	9.7	8.7	10.0	9.7
Germany	-5.3	0.3	1.5	-4.8	1.5	1.9
India	5.4	6.4	7.3	5.6	7.7	7.8
Japan	-5.4	1.7	2.4	-5.3	1.7	2.2
Brazil	-0.7	3.5	3.5	-0.4	4.7	3.7
Russia	-7.5	1.5	3.0	-9.0	3.6	3.4
UK	-4.4	0.9	2.5	-4.8	1.3	2.7
US	-2.7	1.5	2.8	-2.5	2.7	2.4

Source: IMF

World trade in goods and services is expected to decline 12.3% in 2009, but increase 5.8% in 2010. Trade volumes in 2010 are projected to be 5% below the levels of 2007, and exceed 2007 levels by 2011. Imports by advanced economies are expected to decline 12.2% in volume terms during 2009, before increasing 5.5% in 2010 (compared with forecast of 1.2% in WEO, October 2009). 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 11.7% in 2009, before increasing 5.4% in 2010 (compared with forecast of 3.6% in WEO, October 2009).

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

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- ❑ 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.

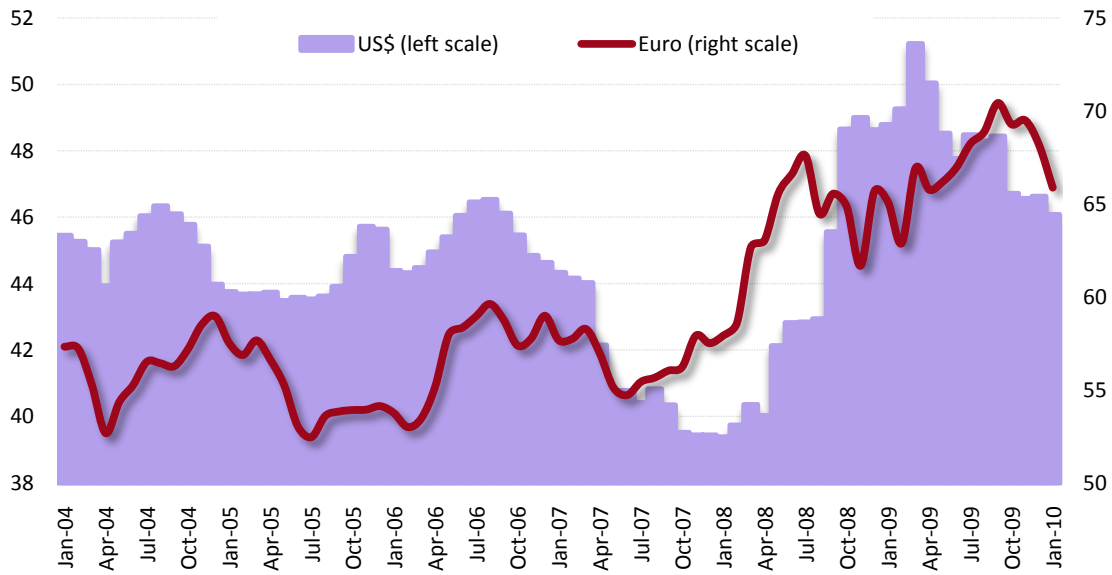
However, the IMF has noted significant risks in both directions. On the upside, the reversal of the confidence crisis and the reduction in uncertainty may result in a stronger-than-expected improvement in financial market sentiment and prompt a larger-than-expected rebound in capital flows, trade, and private demand. On the downside, premature and incoherent exit from supportive policies may undermine global growth and its rebalancing. In addition, rising concerns about worsening budgetary positions and fiscal sustainability could unsettle financial markets and stifle the recovery by raising the cost of borrowing for households and companies.

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 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 46.70 during Q3FY2010, and 46.08 in January 2010. 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. The rupee has also appreciated during FY2010 because of recovery in capital flows, and revival in growth performance of the Indian economy.

Exchange Rate of the Rupee

Rs. Per unit

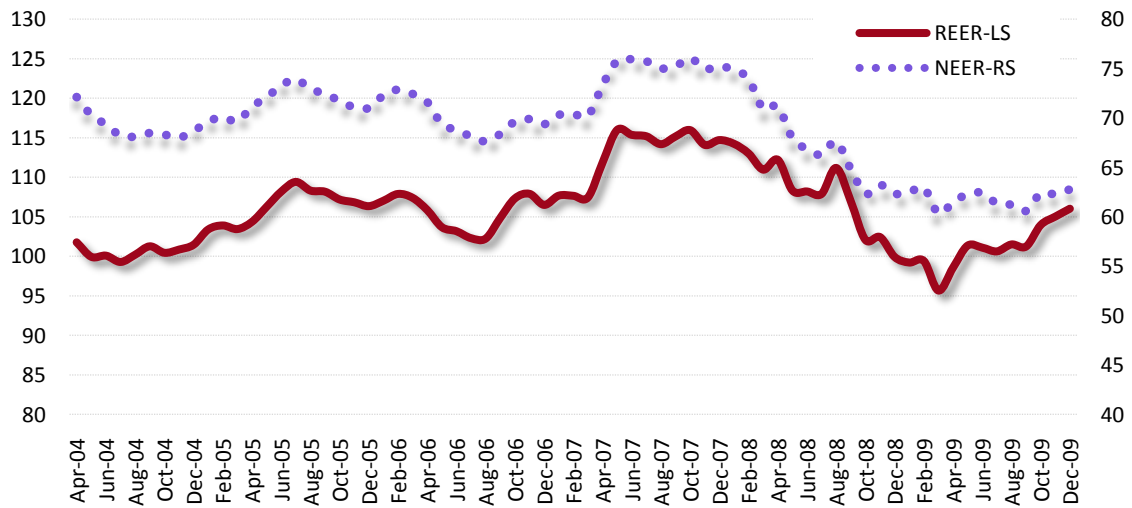


Source: GoI, IMAcS Analysis

While the average 6-currency trade-based nominal effective exchange rate or NEER (base: 1993-94=100) increased 2.1% during April-December 2009, the real effective exchange rate or REER appreciated by 7.6% during April-December 2009, mainly on account of appreciation of the rupee against the US dollar and increase in inflation differential between India and its trading partners.

Indices of NEER and REER

1993-94=100



Source: GoI, IMAcS Analysis

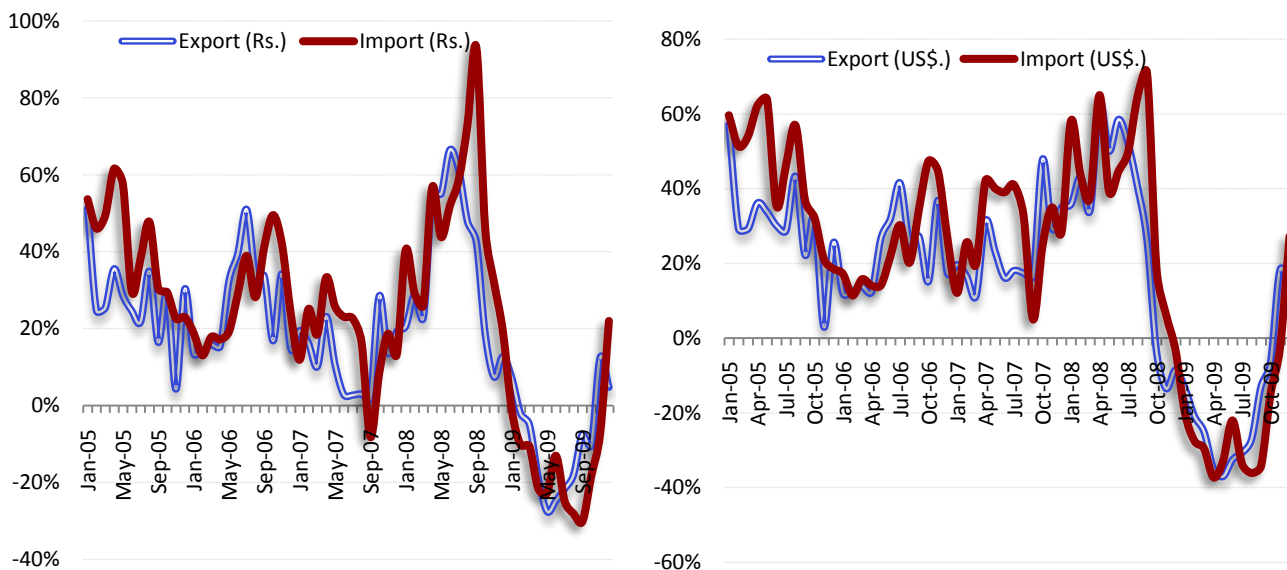
Sharp Contraction in India's Trade since September 2008

Provisional data on India's merchandise trade is available up to December 2009. However, commodity-wise and country-wise details are available only up to September 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 continued to decline on a (yoy) basis till October 2009, the rate of contraction declined. Further, exports increased 18.2% (yoy) in November 2009, representing the first increase in thirteen months. Exports increased 9.3% (yoy) in December 2009. However, the increase seems to be attributable to the base effect. In rupee terms, trade started contracting from January 2009, and the rate of decline has been high, though there has been a sharp improvement since August 2009. In rupee terms, trade growth moderated sharply from 73% (yoy) in August 2008 to -1% (yoy) in January 2009, and was negative during February-November 2009, though the rate of deceleration has been lower in recent months. However, in US\$ terms, trade growth plunged from October 2008 onwards, and has been negative during November 2008-October 2009. However, during December 2009, trade increased 20% (yoy) in US\$ terms and 15% (yoy) in rupee terms. Import growth has been higher than exports reflecting increased crude oil and other commodity import prices during the course of 2009.

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 December 2009 at US\$14.61 billion recorded a yoy increase of 9.3% as against a decline of 8.6% registered in the corresponding month of the previous year. In rupee terms, exports increased 4.8% (yoy) in December 2009 to Rs. 681.07 billion, compared with a growth of 12.7% in the corresponding previous. Overall exports during 9MFY2010 (April-December 2009), at US\$117.59 billion declined 20.3% (yoy). 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 December 2009 at US\$24.75 billion showed increase of 27.2% (yoy) as against a decline of 3.3% (yoy) in December 2008, due to decline in non-oil imports. Overall imports during 9MFY2010 at US\$193.83 billion experienced a decline of 23.6% (yoy).

Quarterly Trends in India's Merchandise Trade

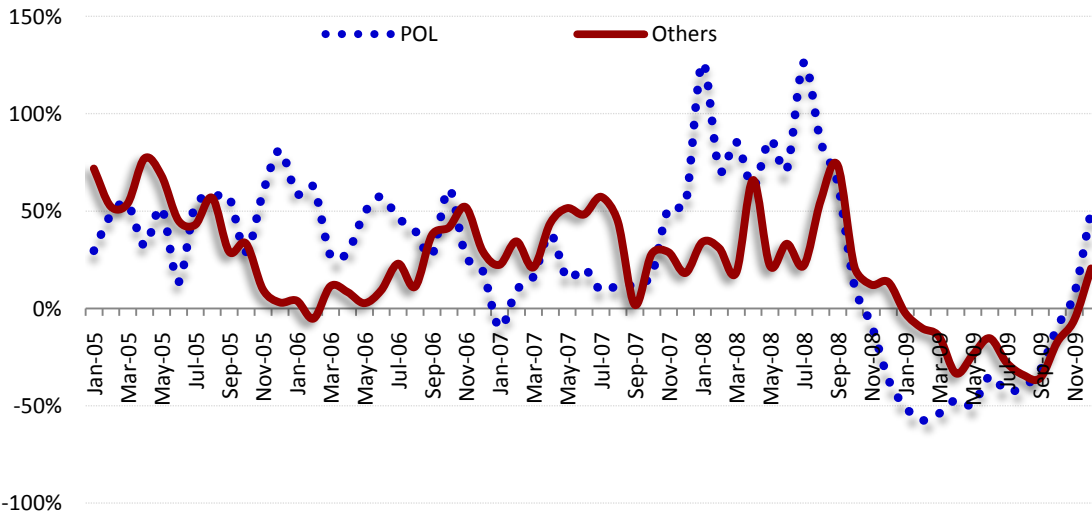
	Rs. Crores		Growth		US\$ million		Growth	
	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports
Q1FY07	132,664	193,008	29.2%	21.7%	29,155	42,431	23.8%	16.7%
Q2FY07	148,971	220,962	39.0%	36.1%	32,126	47,663	31.0%	28.2%
Q3FY07	138,261	223,082	21.1%	38.1%	30,742	49,573	22.2%	39.3%
Q4FY07	151,884	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	59,537	23.1%	40.3%
Q2FY08	152,682	242,014	2.5%	9.5%	37,675	59,712	17.3%	25.3%
Q3FY08	166,574	252,775	20.5%	13.3%	42,209	64,054	37.3%	29.2%
Q4FY08	188,315	267,742	24.0%	31.6%	47,259	67,222	37.4%	45.9%
Q1FY09	234,733	369,333	58.7%	50.6%	56,328	88,712	57.0%	49.0%
Q2FY09	229,718	421,282	50.5%	74.1%	52,578	96,284	39.6%	61.2%
Q3FY09	188,468	335,584	13.1%	32.8%	38,662	68,813	-8.4%	7.4%
Q4FY09	187,835	248,235	-0.3%	-7.3%	37,726	49,887	-20.2%	-25.8%
Q1FY10	178,861	298,670	-23.8%	-19.1%	36,679	61,294	-34.9%	-30.9%
Q2FY10	192,924	304,154	-16.0%	-27.8%	39,846	62,820	-24.2%	-34.8%
Q3FY10	191,208	324,763	1.5%	-3.2%	40,998	69,635	6.0%	1.2%

Source: Gol, IMAcS Analysis

Petroleum, oil and lubricants (POL) imports during 9MFY2010 at US\$56.92 billion, declined by 29.8% (yoy), primarily because of a decline in crude oil prices since September 2008. However, the significant increase in crude oil prices during 2009 has resulted in POL imports increasing 11% (yoy) during Q3FY2010, compared with a decline of 39% (yoy) in Q2FY2010. Non-oil imports during 9MFY2010 at US\$136.91 billion registered a decline of 20.7% (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\$

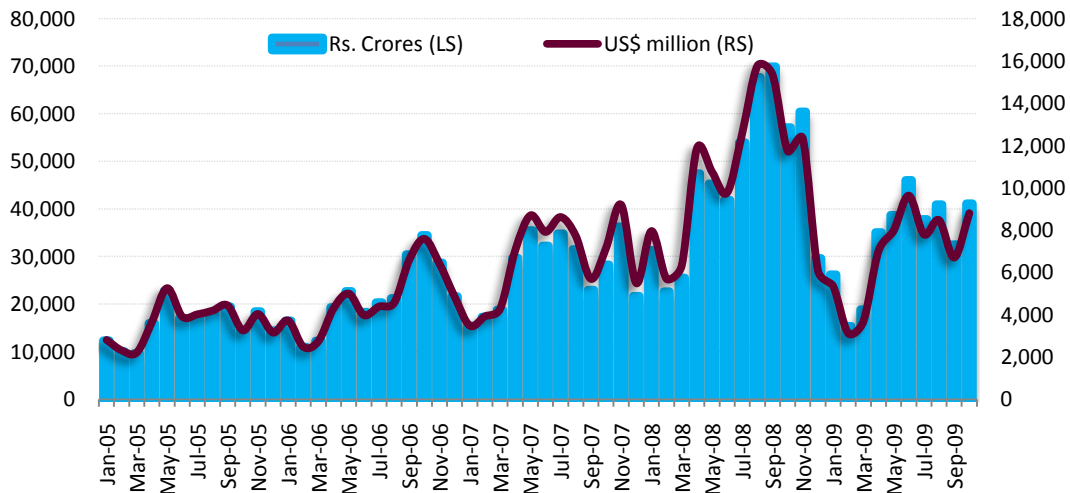


Source: Gol, IMAcS Analysis

Sharp Increase in Trade Deficit in Recent Months

The trade deficit narrowed by US\$30 billion during 9MFY2010 to US\$76.24 billion. In rupee terms, trade deficit narrowed by Rs. 1,086.15 billion to Rs. 3,647 billion. There was a sharp contraction of the trade deficit—from a peak of US\$15.76 billion (Rs. 676.86 billion) during August 2008 to a recent low of US\$3.12 billion (Rs. 153.76 billion) in March 2009. Trade deficit has subsequently increased in March-December 2009 mainly because of a month on month (mom) increase in oil imports since May 2009. On a quarterly basis, trade deficit has increased from US\$12.16 billion (Rs. 604 billion) in Q4FY2009 to US\$28.64 billion (Rs. 1,336 billion) in Q3FY2010.

India's Trade Deficit



Source: Gol, IMAcS Analysis

Commodity-wise Trade Trends

Commodity wise trade trends are available only up to September 2009. During H1FY2010 (April-September 2009), exports of labour intensive sectors such as textiles, gems and jewellery, and ores and minerals have witnessed a decline, as these sectors have been adversely affected under the impact of demand recession, mainly in the developed regions, viz., the US and the EU. Exports of plantation, agricultural, and marine products during H1FY2010 at US\$6.88 billion declined 31.2% (yoy), compared with an increase of 5.5% in FY2009. Within primary products, agricultural and allied products witnessed a sharp deceleration in growth from 55.9% in FY2008 to a decline of 34.1% (yoy) in H1FY2010 driven by slowdown/decline in cereals and spices. However, processed food exports declined at a lower rate of 3.7% (yoy) in H1FY2010. Exports of ores and minerals declined by 35.5% in H1FY2010 from the growth of 30.1% in FY2008 caused by a 33.7% (yoy) decline in iron ore exports. Exports of manufactured goods during H1FY2010 at US\$66.83 billion recorded a decline of 29.2% (yoy) in H1FY2010, compared with growth of 16.3% in FY2009. Within manufactured products, engineering goods exports during H1FY2010 at US\$15.14 billion declined 35% (yoy), compared with a growth of 20% in FY2009. Chemicals and related products exports declined 20.2% (yoy) in H1FY2010 compared with growth of 7.6% in FY2009. All the constituent products experienced a decline, with plastics registering a decline of 22%. Exports of textiles and textile products, during H1FY2010 at US\$9.43 billion declined 15.5% compared with a decline of 5% in FY2009. Except for manmade textiles, all the major components, including the readymade garments, which accounted for about 50% share in textiles and textile product exports witnessed a decline. Gems and jewellery exports declined 21.7% (yoy) in H1FY2010 to US\$13.61 billion, compared with a growth of 44% in FY2009. Gems and jewellery exports increased at a moderate rate till the first half of H1FY2010 but have declined reflecting the recessionary conditions in the major export destinations for India's gems and jewellery, viz., Hong Kong, the US and the UAE. Petroleum products at US\$10.58 billion, which constituted the third largest components of India's exports (after engineering, gems & jewellery), witnessed a sharp decline of 43.5% (yoy) in H1FY2010 compared with a decline of 3% in FY2009.

Commodity-Wise Exports

H1	Rs. Crores		Growth		US\$ million		Growth	
	2009	2010	2009	H1 FY2010	2009	2010	2009	H1 FY2010
Plantation	2,616	2,197	26.6%	-16.0%	610	452	11.4%	-25.9%
Agricultural and Allied Products	36,595	27,582	20.9%	-24.6%	8,614	5,675	7.2%	-34.1%
Marine Products	3,312	3,642	2.0%	10.0%	771	751	-10.9%	-2.6%
Ores and Minerals	19,018	14,025	-2.3%	-26.3%	4,474	2,884	-13.7%	-35.5%
Leather & Manufactures	8,610	7,429	16.0%	-13.7%	2,013	1,531	2.3%	-23.9%
Gems & Jewellery	74,194	66,064	62.3%	-11.0%	17,388	13,608	44.3%	-21.7%
Sports Goods	358	337	22.3%	-5.8%	84	69	8.3%	-17.3%
Chemicals and Related Products	56,535	51,241	22.1%	-9.4%	13,228	10,550	7.6%	-20.2%
Engineering	98,999	73,639	35.6%	-25.6%	23,214	15,144	20.0%	-34.8%
Electronic Goods	16,405	14,988	133.3%	-8.6%	3,828	3,087	104.7%	-19.4%
Project Goods	511	313	7.2%	-38.7%	119	64	-2.4%	-46.4%
Textiles	43,266	42,046	19.0%	-2.8%	10,151	8,657	4.5%	-14.7%
Handicrafts	716	460	-32.4%	-35.9%	167	95	-40.4%	-43.4%
Carpets	1,861	2,037	-6.1%	9.4%	438	419	-17.0%	-4.2%
Cotton Raw	1,653	1,255	-67.7%	-24.1%	400	259	-71.0%	-35.3%
Petroleum Products	79,926	51,399	8.1%	-35.7%	18,721	10,580	-3.0%	-43.5%
Others	19,875	13,442	109.8%	-32.4%	4,686	2,764	87.9%	-41.0%
Total	464,450	372,096	28.2%	-19.9%	108,907	76,589	13.6%	-29.7%

Source: GoI, IMAcS Analysis

Commodity-wise imports data for H1FY2010 indicate a 41% (yoy) decline in POL imports, compared with growth of a growth of 17.4% in FY2009. Non-POL imports witnessed a decline of 29% (yoy) in H1FY2010, mainly due to deceleration in imports of items such as capital goods and gold and silver, and decline in commodity prices.

Commodity-Wise Imports

H1	Rs. crores		Growth		US\$ million		Growth	
	2009	2010	2009	H1 FY2010	2009	2010	2009	H1 FY2010
Bulk Imports	384,851	259,623	38.0%	-32.5%	90,004	53,502	23.3%	-40.6%
of which Petroleum crude & products	270,534	181,431	31.0%	-32.9%	63,285	37,386	17.4%	-40.9%
Pearls, Precious, Semi-Precious	44,582	26,394	137.1%	-40.8%	10,430	5,430	111.3%	-47.9%
Stones	94,760	70,670	2.8%	-25.4%	22,232	14,534	-9.5%	-34.6%
Machinery	6,496	9,998	181.6%	53.9%	1,521	2,061	146.4%	35.5%
Project Goods	259,926	236,520	38.7%	-9.0%	60,809	48,667	22.9%	-20.0%
Total	790,616	603,205	35.8%	-23.7%	184,996	124,194	20.7%	-32.9%

Source: GoI, IMAcS Analysis

Country-Wise Export Trends

Destination-wise, during April-September 2009, among the regions, Middle East, EU-27, North America and ASEAN were the major markets for India's exports. Exports to all regions have declined during H1FY2010.

Destination-Wise Exports

H1	US\$ million		Growth		Share of Exports		
	2009	2010	2009	H1 FY2010	2004-08	2009	H1 FY2010
EU-27	22,035	15,345	13.9%	-30.4%	21.7%	21.2%	20.0%
UK	3,580	2,816	-0.8%	-21.4%	4.5%	3.6%	3.7%
GERMANY	3,676	2,808	24.7%	-23.6%	3.3%	3.4%	3.7%
ITALY	3,469	2,343	20.9%	-32.4%	2.8%	3.4%	3.1%
FRANCE	1,641	1,374	16.2%	-16.3%	1.8%	1.6%	1.8%
OTHER WESTERN EUROPE	1,626	1,011	-1.9%	-37.8%	1.6%	1.4%	1.3%
EAST EUROPE	69	51	20.3%	-26.7%	0.1%	0.1%	0.1%
SOUTHERN AFRICA	1,872	1,605	-12.9%	-14.3%	1.9%	1.7%	2.1%
SOUTH AFRICA	1,202	1,046	-25.6%	-13.0%	1.5%	1.1%	1.4%
WESTERN AFRICA	1,629	1,424	-3.0%	-12.6%	2.0%	1.8%	1.9%
CENTRAL AFRICA	191	160	49.3%	-16.3%	0.2%	0.2%	0.2%
EAST AFRICA	3,053	1,723	7.0%	-43.5%	2.0%	2.4%	2.3%
NORTH AMERICA	12,491	9,323	2.3%	-25.4%	16.2%	12.2%	12.2%
USA	11,766	8,794	2.0%	-25.3%	15.2%	11.4%	11.5%
LATIN AMERICA	3,867	2,385	8.8%	-38.3%	3.0%	3.3%	3.1%
BRAZIL	1,815	893	5.0%	-50.8%	1.1%	1.4%	1.2%
EAST ASIA	1,013	780	24.2%	-23.0%	1.0%	0.9%	1.0%
AUSTRALIA	798	611	24.9%	-23.4%	0.8%	0.8%	0.8%
ASEAN	11,568	8,331	16.6%	-28.0%	9.9%	10.3%	10.9%
INDONESIA	1,596	1,558	32.8%	-2.4%	1.6%	1.8%	2.0%
SINGAPORE	5,709	3,312	14.4%	-42.0%	4.6%	4.6%	4.3%
WANA	26,014	18,668	37.3%	-28.2%	17.5%	22.5%	24.4%
UAE	15,465	11,020	56.5%	-28.7%	9.0%	13.2%	14.4%
SAUDI ARABIA	3,413	2,060	37.7%	-39.6%	2.0%	2.8%	2.7%
NORTH EAST ASIA	14,527	10,821	-4.0%	-25.5%	15.7%	13.7%	14.1%
CHINA	4,998	3,903	-14.0%	-21.9%	6.4%	5.0%	5.1%
HONG KONG	3,802	3,465	5.4%	-8.9%	4.2%	3.6%	4.5%
JAPAN	1,680	1,429	38.2%	-15.0%	2.2%	2.1%	1.9%
KOREA, SOUTH	1,977	1,270	-21.6%	-35.7%	1.9%	1.6%	1.7%
SOUTH ASIA	5,061	3,521	-11.1%	-30.4%	5.7%	4.6%	4.6%
SRI LANKA	1,489	1,042	-14.6%	-30.0%	1.8%	1.3%	1.4%
CAR COUNTRIES	138	121	11.2%	-11.8%	0.2%	0.1%	0.2%
OTHER CIS	1,016	572	10.5%	-43.7%	1.1%	0.9%	0.7%
RUSSIA	672	411	16.6%	-38.9%	0.7%	0.6%	0.5%
UNSPECIFIED	2,736	749	730.3%	-72.6%	0.3%	2.5%	1.0%
Total	108,907	76,589	13.6%	-29.7%	100%	100%	100%

Source: GoI, IMaCS Analysis

BALANCE OF PAYMENTS TRENDS

BOP Trends for Q2FY2010

Current Account

As can be seen from India's BOP statistics, preliminary data for Q2FY2010 indicate that the merchandise trade deficit contracted sharply from its peak of US\$39.1 billion in Q2FY2009 to US\$20.20 billion in Q4FY2009, but increased to US\$32.20 billion in Q2FY2010, as imports increased at a faster rate than exports. On a BOP basis, India's merchandise exports posted a decline of 21% (yoy) in Q2FY2010, compared with a higher decline of 32.5% (yoy) in Q1FY2010. Import payments declined by 19.6% (yoy) in Q2FY2010, compared with a decline of 21.7% (yoy) in Q1FY2010. The decline in imports is mainly attributed to the base effect and decline in oil prices.

Although merchandise trade deficit increased in Q1FY2010 and Q2FY2010, invisibles receipts declined in Q1FY2010 before increasing in Q2FY2010. Invisibles receipts registered a yoy decline of 15.1% in Q2FY2010 compared with a (yoy) decline of 7.5% in Q1FY2010 on account of a decline in almost all categories of services (except insurance and financial services), official transfers and investment income receipts. Invisibles receipts from services declined primarily because of a decline in software services receipt reflecting the impact of global economic slowdown. Overall services exports witnessed a decline of 28.8% (yoy) in Q2FY2010, compared with a decline of 12.5% (yoy) in Q1FY2010. Software services receipts have declined from their FY2009 peak level of US\$12.12 billion in Q2FY2009 to US\$10.65 billion in Q3FY2010. Software exports at US\$21.41 billion in H1FY2010 were substantially lower than software exports of US\$24.20 billion recorded in H1FY2009. Invisibles payments increased 0.2% (yoy) in Q2FY2010 (compared with a decline of 5.6% in Q1FY2010) mainly led by sharp increases in payments under insurance, business services, financial services, and communication services account. In net terms, the invisibles balance of US\$19.58 billion during Q2FY2010 was substantially lower than that in the corresponding period of the previous year (US\$26.55 billion), which represented the peak invisibles balance.

Summarised BOP Balance (US\$ million)

Item	FY2009				FY2010	
	Q1	Q2	Q3	Q4	Q1	Q2
I. MERCHANDISE	-25,277	-39,121	-34,049	-20,204	-26,016	-32,201
II. INVISIBLES (a+b+c)	22,003	26,546	22,381	18,992	20,022	19,576
a) Services	10,710	14,400	13,851	10,670	9,098	6,273
b) Transfers	12,143	12,942	10,151	9,562	12,878	13,702
c) Income	-849	-796	-1,621	-1,240	-1,953	-399
A. TOTAL CURRENT ACCOUNT	-3,274	-12,575	-11,668	-1,212	-5,993	-12,625
1. Foreign Investment (a+b)	4,757	3,591	-5,374	493	15,294	16,794
a) Foreign Direct Investment	8,964	4,903	446	3,185	7,025	7,116
b) Portfolio Investment	-4,207	-1,311	-5,820	-2,692	8,268	9,678
2. Loans (a+b+c)	6,333	2,607	548	-820	-1,820	2,518
a) External Assistance	351	518	992	777	84	487
b) Commercial Borrowings	1,479	1,687	3,778	997	-441	1,186
c) Short Term to India	4,503	402	-4,221	-2,594	-1,463	845
3. Banking Capital (a+b)	2,696	2,275	-4,956	-3,260	-3,365	4,423
a) Commercial Banks	2,847	2,277	-4,528	-3,371	-3,127	4,555
b) Others	-151	-3	-429	111	-238	-132
4. Rupee Debt Service	-30	-3	—	-68	-23	-1
5. Other Capital	-8,904	-1,372	3,668	5,063	-4,131	-121
B. TOTAL CAPITAL ACCOUNT	4,853	7,099	-6,114	1,408	5,955	23,613
C. ERRORS AND OMISSIONS	656	742	-100	104	153	-1,570
D. OVERALL BALANCE	2,235	-4,734	-17,881	300	115	9,418

Source: RBI, IMAcS analysis

Summarised BOP Balance (Rs. billion)

Item	FY2009				FY2010	
	Q1	Q2	Q3	Q4	Q1	Q2
I. MERCHANDISE	-1,052.92	-1,712.72	-1,660.31	-1,005.63	-1,269.27	-1,559.11
II. INVISIBLES (a+b+c)	916.55	1,162.19	1,091.39	945.31	976.87	947.83
a) Services	446.12	630.43	675.43	531.11	443.88	303.73
b) Transfers	505.81	566.61	495.02	475.94	628.28	663.43
c) Income	-35.38	-34.86	-79.05	-61.74	-95.29	-19.33
A. TOTAL CURRENT ACCOUNT	-136.37	-550.53	-568.92	-60.32	-292.40	-611.28
1. Foreign Investment (a+b)	198.17	157.23	-262.07	24.53	746.17	813.12
a) Foreign Direct Investment	373.40	214.63	21.74	158.53	342.76	344.56
b) Portfolio Investment	-175.24	-57.40	-283.81	-134.00	403.40	468.56
2. Loans (a+b+c)	263.82	114.15	26.74	-40.82	-88.80	121.92
a) External Assistance	14.61	22.68	48.35	38.66	4.11	23.58
b) Commercial Borrowings	61.63	73.85	184.21	49.62	-21.53	57.41
c) Short Term to India	187.59	17.62	-205.83	-129.10	-71.39	40.92
3. Banking Capital (a+b)	112.31	99.59	-241.69	-162.26	-164.20	214.14
a) Commercial Banks	118.60	99.70	-220.78	-167.79	-152.56	220.52
b) Others	-6.30	-0.11	-20.91	5.53	-11.63	-6.39
4. Rupee Debt Service	-1.23	-0.12	—	-3.36	-1.10	-0.04
5. Other Capital	-370.91	-60.06	178.87	252.02	-201.52	-5.85
B. TOTAL CAPITAL ACCOUNT	202.16	310.79	-298.15	70.10	290.54	1,143.28
C. ERRORS AND OMISSIONS	27.31	32.49	-4.87	5.15	7.47	-76.01
D. OVERALL BALANCE	93.10	-207.25	-871.93	14.93	5.61	456.00

Source: RBI, IMAcS analysis

With the marginal (yoy) increase in invisibles payments accompanied by a (yoy) decline in invisibles receipts, the net invisibles (invisibles receipts minus invisibles payments) was US\$19.58 billion in Q2FY2010, which was lower by US\$446 million over Q1FY2010, and by US\$6,970 million over Q2FY2009. At this level, the invisibles surplus financed about 60.8% of trade deficit during Q2FY2010, compared with 77% during Q1FY2010, 68% during Q2FY2009, and 94% during Q4FY2009.

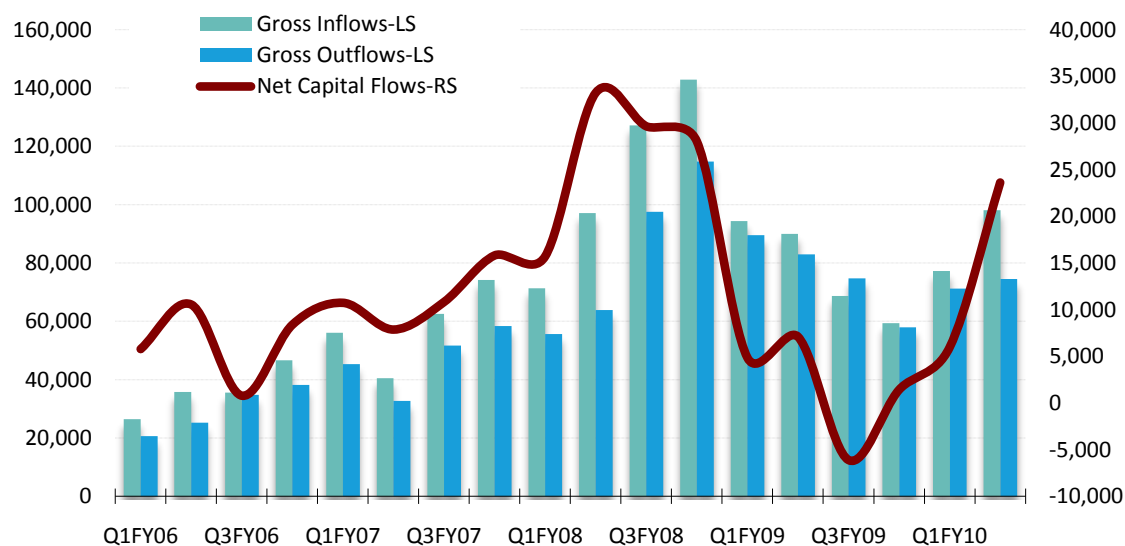
Overall, the net surplus under invisibles not only fully financed the lower trade deficit observed during Q4FY2009 but also led to a surplus in the current account; last recorded during Q4FY2007. However, this positive development could not be continued into FY2010. Despite net invisibles surplus of US\$19.58 billion in Q2FY2010, the rising trade deficit led to a current account deficit of US\$12.63 billion (Rs. 611.28 billion) in Q2FY2010, compared with a deficit of US\$1.21 billion (Rs. 60.32 billion) in Q4FY2009.

Capital Account

Reversing the trend of negative capital account balance during Q3FY2009, the capital account has showed a rising positive balance with balance of US\$23.61 billion (Rs. 1,143.28 billion) in Q2FY2010. Gross capital inflows to India revived during Q1FY2010, and the momentum was sustained in Q2FY2010. Gross inflows increased from US\$77.23 billion in Q1FY2010 to US\$98.11 billion in Q2FY2010. However, they are still substantially lower than the peak of US\$142.83 billion achieved in Q4FY2008. Compared with declines in H2FY2010, gross inflows increased in Q1FY2010 and Q2FY2010. During Q2FY2010, gross inflows increased 27% quarter on quarter (qoq) or by US\$20.88 billion led by a 15.3% (qoq) increase in foreign investments and 23.8% (qoq) increase in loans.

Trends in Capital Flows

US\$ million



Net FDI inflows (net inward FDI minus net outward FDI) have increased sharply from a recent negative figure of US\$5,374 million in Q3FY2009 to US\$15.29 billion in Q1FY2010, and to US\$16.79 billion in Q2FY2010. The increase has been accounted by a higher increase in inward FDI accompanied by an increase in outward FDI. More recent data by the Department of Industrial Policy & Promotion (DIPP)

indicates that FDI equity inflows aggregated US\$20.92 billion (Rs. 1,005.39 billion) in 9MFY2010. For 2009 as a whole however, FDI equity inflows declined 18% in US\$ terms to US\$27.10 billion. In rupee terms, FDI equity inflows declined 6% in 2009 to Rs. 1,312.37 billion.

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, and US\$9.68 billion in Q2FY2010. This is primarily accounted for by gross FII investments which after plunging from US\$74.24 billion in Q4FY2008 to US\$18.66 billion in Q4FY2009, increased to US\$44.36 billion in Q2FY2010. The tightness in liquidity in the overseas markets continued during Q1FY2010. However, inflows under GDR/ADRs increased from US\$20 million in Q1FY2010 to US\$2.66 billion in Q2FY2010 due to growth of stock prices of Indian companies.

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 during Q3FY2009 to Q2FY2010, but was at US\$4.42 billion in Q2FY2010 caused largely by a substantial decline in outward flows than any significant increase in inflows.

The increase in foreign exchange reserves on a BOP basis (i.e., excluding valuation) was US\$9,418 million in Q2FY2010, as compared with increase of US\$115 million in Q1FY2010, and declines during Q2FY2009 and Q3FY2009. The increase in the reserves was mainly due to large capital inflows and Special Drawing Rights (SDR) allocations by the IMF. According to the guidelines given in the Sixth Edition of the Balance of Payments Manual (BPM6) of the International Monetary Fund (IMF), allocations under SDRs are treated as liabilities to nonresidents (foreign liabilities) and reported as liabilities under other investments of the financial account of the balance of payments. Accordingly, a general allocation of SDRs 3,082.5 million on August 28, 2009 and a special allocation of SDRs 214.6 million together amounting to US\$5.2 billion is included in the 'other capital' of the capital account of the BoP for Q2FY2010. The allocations have a debit entry in the reserve assets of the BoP showing an equal amount of increase in the foreign exchange reserves.

Detailed BOP Statistics

US\$ billion

Item	Q1FY2010			Q2FY2010		
	Credit	Debit	Net	Credit	Debit	Net
I. MERCHANDISE	38.79	64.80	-26.02	42.35	74.55	-32.20
II. INVISIBLES (a+b+c)	36.46	16.44	20.02	38.91	19.33	19.58
a) Services of which	20.17	11.07	9.10	19.89	13.62	6.27
Travel	2.29	2.00	0.28	2.52	2.39	0.13
Transportation	2.49	2.78	-0.29	2.57	2.22	0.35
Insurance	0.39	0.31	0.07	0.38	0.34	0.04
Miscellaneous	14.91	5.87	9.03	14.32	8.53	5.79
of which Software Services	10.76	0.39	10.37	10.65	0.44	10.21
b) Transfers	13.34	0.47	12.88	14.27	0.57	13.70
i) Official	0.05	0.11	-0.06	0.05	0.11	-0.05
ii) Private	13.30	0.36	12.94	14.22	0.46	13.76
c) Income	2.95	4.90	-1.95	4.75	5.15	-0.40
i) Investment Income	2.72	4.57	-1.84	4.54	4.79	-0.25
ii) Compensation of Employees	0.23	0.34	-0.11	0.21	0.36	-0.15
A. TOTAL CURRENT ACCOUNT (I+II)	75.25	81.24	-5.99	81.26	93.88	-12.63
1. Foreign Investment (a+b)	48.43	33.14	15.29	55.82	39.02	16.79
a) Foreign Direct Investment (i+ii)	9.81	2.78	7.03	11.46	4.34	7.12
i. In India	9.68	0.03	9.65	11.36	0.04	11.33
ii. Abroad	0.13	2.75	-2.63	0.10	4.30	-4.21
b) Portfolio Investment	38.63	30.36	8.27	44.36	34.68	9.68
i) In India	38.60	30.33	8.27	44.36	34.66	9.70
of which FII's	38.56	30.33	8.23	41.69	34.66	7.04
GDRs/ADRs	0.04		0.04	2.66	0.00	2.66
ii) Abroad	0.02	0.03	0.00	0.00	0.03	-0.02
2. Loans (a+b+c)	12.92	14.74	-1.82	16.00	13.48	2.52
a) External Assistance	0.82	0.74	0.08	1.24	0.75	0.49
i) By India	0.01	0.12	-0.10	0.01	0.12	-0.10
ii) To India	0.81	0.62	0.19	1.22	0.63	0.59
b) Commercial Borrowings	1.97	2.42	-0.44	3.19	2.01	1.19
i) By India	0.24	0.33	-0.09	0.21	0.22	-0.01
ii) To India	1.73	2.08	-0.35	2.99	1.79	1.20
c) Short Term to India	10.13	11.59	-1.46	11.57	10.72	0.85
i) Suppliers' Credit > 180 days & Buyers' Credit	10.13	9.59	0.54	10.99	10.72	0.27
ii) Suppliers' Credit up to 180 days		2.00	-2.00	0.57		0.57
3. Banking Capital (a+b)	15.58	18.94	-3.37	16.54	12.12	4.42
a) Commercial Banks	15.58	18.70	-3.13	16.54	11.99	4.56
of which : Non-Resident Deposits	11.17	9.35	1.82	10.34	9.30	1.05
b) Others		0.24	-0.24		0.13	-0.13
4. Rupee Debt Service		0.02	-0.02		0.00	0.00
5. Other Capital	0.30	4.43	-4.13	9.75	9.87	-0.12
B. TOTAL CAPITAL ACCOUNT (1-5)	77.23	71.27	5.96	98.11	74.50	23.61
C. ERRORS AND OMISSIONS	0.15		0.15		1.57	-1.57
D. OVERALL BALANCE	152.63	152.51	0.12	179.36	169.95	9.42

Source: RBI, ImaCS analysis

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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. US GDP increased 0.1% (yoy) in 4Q2009 (1.4% qoq), compared with a 2.6% (yoy) decline in 3Q2009 (0.6% qoq). 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. After posting weak GDP growth of just 0.3% (qoq) in 3Q2009, the economy has recovered with a 1.1% (qoq) increase in 4Q2009. However, the recovery is likely to be slow and huge economic slack and weak domestic demand is likely to further entrench deflation.
- In the eurozone, after the 0.4% (qoq) increase in GDP posted in 3Q2009, growth slowed down to 0.1% (qoq) in 4Q2009 because of the end of stimulus packages in many countries and reduced impetus from the inventory cycle. On a (yoy) basis, GDP has continued to decline through 2009 with a 2.1% (yoy) decline in 4Q2009. Signs of sustained recovery in the euro area are not yet as clearly visible, reflecting country specific combinations of bursting housing bubbles, export setbacks and damage to financial sectors. Credit growth has continued to weaken because of weak economic activity and deleveraging by the private sector. 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. Unemployment rate reached 10% in November-December 2009, and could have been higher but for a variety of government-sponsored schemes. For the euro area this is the highest rate since August 1998, and for the EU-27 since the start of the series in January 2000. The risk is that government-sponsored measures

would have only delayed job losses, if demand proves to be weak into 2010.

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. With regard to the actual trade data, estimated seasonally adjusted exports from China have been significantly higher in the last few months of 2009; total exports were estimated to have increased 15% (yoy) in 4Q2009.
- 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 from the second quarter of 2009 as domestic demand firmed due to improving credit conditions and fiscal stimulus. However, data for 3Q2009 was disappointing with GDP increasing 1.3% compared with the consensus forecast of 2%. Nevertheless, investments have rebounded from the slump till 1Q2009, and consumer spending has risen 2% (qoq).
- 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.

ECONOMIC SURVEY—KEY HIGHLIGHTS

On February 25, 2010, the Government released the Economic Survey for 2009-10 noting that the fiscal year 2009-10 began as a difficult and uncertain one. A delayed and severely subnormal monsoon added to the overall uncertainty. The continued recession in the developed world, for the better part of 2009-10, meant a sluggish export recovery and a slowdown in financial flows into the economy. Yet, over the span of FY2010, the economy posted a remarkable recovery, not only in terms of overall growth figures but, more importantly, in terms of certain fundamentals, which justify optimism for the Indian economy in the medium to long term. The key highlights and policy recommendations of the Economic Survey are discussed below:

Real GDP Growth and Prospects

- The real turnaround came in Q2FY2010 when the economy grew at 7.9% (yoy), compared with 6.1% (yoy) in Q1FY2010. As per the advance estimates of GDP for 2009-10, the economy is expected to grow at 7.2% in FY2010 with the industrial and the service sectors growing at 8.2% and 8.7%, respectively. This recovery is impressive for at least three reasons:
 - it has come about despite a decline of 0.2% in agricultural output, which was the consequence of sub-normal monsoons.
 - the recovery foreshadows renewed momentum in the manufacturing sector, which had seen continuous decline in the growth rate for almost eight quarters since 2007-08. Indeed, manufacturing growth has more than doubled from 3.2% in FY2009 to 8.9% in FY2010, which is nevertheless significantly below its peak growth rate of 14.9% in FY2007.
 - there has been a recovery in the growth rate of gross fixed capital formation (GDCF), which had declined significantly in FY2009. While the growth rates of private and Government final consumption expenditure have dipped in private consumption demand, there has been a pick-up in the growth of private investment demand. There has also been a turnaround in merchandise export growth in November 2009, which has been sustained in December 2009, after a decline nearly twelve continuous months.

- The recovery in GDP growth for FY2010 is broad based. Seven out of eight sectors/sub-sectors show a growth rate of 6.5% or higher. The exception, as anticipated, is agriculture and allied sectors. Sectors including mining and quarrying; manufacturing; and electricity, gas and water supply have significantly improved their growth rates at over 8%. The construction sector and trade, hotels, transport and communication have also improved their growth rates, though to a lesser extent. However, the growth rate of community, social and personal services has declined significantly. Financing, insurance, real estate and business services have retained their growth momentum at around 10% in FY2010.

- A major concern during FY2010, especially in the second half, was the emergence of high double-digit food inflation. On a year-on-year (yoy) basis, wholesale price index (WPI) headline inflation in December 2009 was 7.3%, but for food items (primary and manufactured) with a combined weight of 25.4% in the WPI basket, it was 19.8%. Thus, unlike the first half of 2008-09 when global cost-push factors resulted in WPI inflation touching nearly 13% in August 2008, with inflation in primary and manufactured products just below the overall average and that in the fuel and power group at over 17%, the upsurge in prices in the second half of 2009-10 has been more concentrated and confined to food items only. A significant part of this inflation can be explained by supply-side bottlenecks in some of the essential commodities, precipitated by the delayed and sub-normal southwest monsoons. Since December 2009, there have been signs of these high food prices, together with the gradual hardening of non-administered fuel product prices, getting transmitted to other non-food items, thus creating some concerns about higher than- anticipated generalized inflation over the next few months.
- The Survey has noted that there are several factors that have emerged from the performance of the economy in the last 12 months, which, combined with an analysis of performance over the last couple of years, augur well for the Indian economy. There are some deep changes that have taken place in India, which suggest that the economy's fundamentals are strong.
 - the rates of savings and investment have reached levels that even ten years ago would have been dismissed as a pipedream for India.
 - the arrival of India's corporations in the global market place and informal indicators of the sophisticated corporate culture that many of these companies exhibit also lend to the optimistic prognosis for the economy in the medium to long run.
- In the medium term it is reasonable to expect that the economy will go back to the robust growth path of around 9% that it was on before the global crisis slowed it down in 2008. For 2010-11, the Survey has noted that a reasonable forecast is that the economy will improve its GDP growth by around 1 percentage point from that witnessed in 2009-10. Thus, allowing for factors beyond the reach of domestic policymakers, such as the performance of the monsoon and rate of recovery of the global economy, the Indian GDP can be expected to grow around 8.5 +/- 0.25%, with a full recovery, breaching the 9% mark in 2011-12.
- The Survey has noted it is entirely possible for India to move into the rarefied domain of double-digit growth and even attempt to don the mantle of the fastest-growing economy in the world within the next four years. If this can be coupled with targeted Government interventions, some of which have recently been undertaken and some that are on the agenda, to include the marginalized segments of the population in this development process, then the ultimate aim of rapid growth, which is to raise the standard of living of the disadvantaged and to eradicate poverty, should also be within reach in the not-too-distant future.

Agriculture and Food Management

- The Economic Survey has noted for three consecutive years (2005-06 to 2008-09), foodgrains production recorded an average annual increase of over 8 million tonnes (mt). However, deficiency in rainfall in the south-west monsoon season during 2009 severely affected kharif crops, especially paddy. The recovery of monsoon in September and post-monsoon (October-December) cumulative rainfall of 8% above normal protected the kharif crops to some extent and

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improved the prospects of rabi crops in 2009-10.

- ❑ As per the first advance estimates (kharif only) for 2009-10, production of foodgrains is estimated at 98.83 mt which is lower than the target of 125.15 mt set for the year as also lower than the fourth advance estimates (kharif only) of 117.70 mt for 2008-09. The Survey says that the country has been able to manage one of the most deficient monsoons with concerted efforts of the State Governments and the Centre. Several incentives and concessions allowed to farmers by the States and Central Government resulted in minimizing the loss in kharif production and maximizing rabi production. The sector, however, faces various challenges which need to be addressed sooner than later says the Survey.
- ❑ The Economic Survey 2009-10 has made a strong comment that the rise in food prices, spurred by expectations of short fall in food production, have brought the issues of food security, food stock management and need for improving food production and productivity to the forefront of national strategy.
- ❑ The Economic Survey 2009-10 has called for addressing the challenges of the agricultural sector through comprehensive and coordinated efforts. Renewed attention needs to be paid to improving farm production and productivity, better utilization of agricultural inputs, proper marketing infrastructure and support, stepping up investment in agriculture with due emphasis on environmental concerns and efficient food management.
- ❑ Although the yield per hectare of foodgrains has shown some improvement in recent years, it is not sufficient to cater to the needs of the rising population when income levels are also rising. Since farm productivity is not showing desirable growth, the Survey feels that there is an urgent need to focus on research as well as better agricultural practices to ensure that productivity levels are increased in the shortest period of time. The Survey feels that special attention is required for States with relatively low productivity.
- ❑ The Survey has also expressed concern regarding the production and productivity in pulses and oilseeds. Though a sizeable portion of these items is met through imports, the scope of import of pulses is limited due to the limited number of countries producing it. This resultant supply-demand gap, leads to the fluctuation of domestic prices.
- ❑ The Economic Survey has raised deep concern over the consistent decline in the share of private sector investment in the agriculture sector. It says that this trend needs to be reversed through creation of a favourable policy environment and availability of credit at reasonable rates on time for private sector to invest in agriculture.
- ❑ The Survey has also said that the inability of a large number of small and marginal farmers to directly access the agricultural markets puts a question mark on increases in the Minimum Support Price (MSP) actually benefiting such farmers though there has been a substantial increase in MSP of various crops over the last few years.
- ❑ The Survey has also called for crop improvement and research to develop drought resistant high yielding varieties of seeds in view of the adverse impact of climate change on agriculture.

Fiscal Issues

- ❑ The survey noted that the fiscal space generated in the 2004-05 to 2007-08 period, following the Fiscal Responsibility and Budget Management (FRBM) Act, mitigated the knock on effects of global financial and economic crisis in 2008-09 through facilitation of an expansionary fiscal stance to boost aggregate demand. While traditionally the assessment of public finances was confined to analysis of fiscal indicators, the macro economy-wide impact of the crisis underscored the importance of using national accounts data in tandem in such assessments.
- ❑ As per the national accounts data, in 2008-09, the deceleration in growth in private final consumption expenditure was partly made up for by the growth in Government consumption expenditure, which resulted in a shoring up of the overall economic growth rate.
- ❑ For FY2010, the Economic Survey shows a revenue expenditure of Rs. 897,232 crore against the receipts of Rs. 614,497 crore thereby leaving a deficit of Rs. 282,735 crore (BE). For the period April-December 2009, the revenue receipts were Rs. 389,271 crore i.e. 63.3% of the BE for the year. The total financial deficit for 2009-10 is estimated at Rs. 400,996 crore. As per cent of GDP, the financial deficit for 2009-10 (BE) is 6.5% compared to 5.9% for 2008-09. Revenue receipts as percent of GDP are pegged at 10% whereas revenue expenditure is estimated to be 14.6%, thereby leaving a revenue deficit of 4.6% of GDP.
- ❑ On the revenue side, the Budget for 2009-10 estimated growth in gross tax revenue at 5.1% composed of a 9.4% growth in direct taxes and an envisaged growth of almost the same level in indirect taxes. However, for April-December 2009, gross tax revenue has declined by 2.5%, composed of a 13.2% growth in direct taxes and 20.4% decline in indirect taxes. The declining trend in revenue collection from indirect taxes, which started in 2008-09, continues in the current fiscal on account of the duty reductions carried out between December 2008 and February 2009. These are now showing their full impact on revenue collection during 2009-10. However, on a month-on-month basis, the decline in gross tax revenues is getting moderated. On the expenditure side, data reveal that total expenditure in April-December 2009 grew by 18.5% (as against the 15.8% growth envisaged by the BE) and as a proportion of the BE for the year was placed at 69.3%. Plan expenditure grew by 23.0% and was at 64.6% of the BE in April-December 2009. Non-Plan expenditure grew by 16.6% (as against the growth of 14.8% envisaged by the BE) and as a proportion of BE for the year was placed at 71.5%. Growth in two components, namely pensions and subsidies, has been faster than envisaged by the BE. Fiscal and revenue deficits were placed at 77.3% and 88.9% of the BE respectively reflecting the developments in revenue and expenditure in tandem.
- ❑ The Survey has noted that based on the trends available for April-December 2009, there is likely to be a shortfall in revenue receipts on account of the large decline in indirect taxes like customs and excise and the likely lower-than-budgeted non-tax revenues. With some expenditure restraint, as a proportion of the GDP, it might still be possible to contain the fiscal deficit at budgeted levels of 6.8% of GDP in 2009-10.
- ❑ The reversal in major fiscal deficit indicators in 2008-09 and 2009-10 constitutes a conscious policy-driven stimulus to counter the demand slowdown. As the impact of the crisis continued through 2009-10, the expansionary fiscal stance was continued in the Budget for 2009-10.

However, such an expansion could only be a short-term measure and the Medium Term Fiscal Policy Statement presented along with the Budget for 2009-10 favoured a resumption of the fiscal consolidation process, albeit a gradual one, with fiscal deficit (as percent of GDP) declining from 6.8% (budget estimates or BE) in FY2010, to 5.5% in FY2011, and 4% in FY2012. The resumption of the path of fiscal prudence would complement the recovery process in the near term and lay the foundation for reviving the growth momentum in the long term.

- While the current year's performance is relevant mainly in the context of fiscal marksmanship given the expansionary stance, it is the medium-term prospect that is really important. The largely structural nature of fiscal deficits in India, the levels of recovery in the economy and the sustainability of the recovery without fiscal stimulus call for resumption of the process of fiscal consolidation in a gradual manner. The Report of the Thirteenth Finance Commission has provided an assessment of the state of public finances and the broad direction of fiscal consolidation by the Centre and States. Going forward, the nature of the fiscal consolidation—whether it should rely on revenue growth, which is in turn linked to the growth recovery, or on greater expenditure cuts—are important in the traditional incremental adjustment process; but lasting fiscal consolidation could accrue with reforms in the design and delivery of Plan schemes, outcome focus of expenditure and institutional reforms.
- The Survey has noted that the recommendations of the Thirteen Finance Commission (FC-XIII) have to be taken on board in shaping the fiscal policy for FY2011 and in the medium term. The FC-XIII has recommended a calibrated exit strategy from the expansionary fiscal stance of FY2009-10 as the main agenda of the Central Government. Further, it has suggested that the revenue deficit of the Centre needs to be progressively reduced and eliminated, followed by emergence of revenue surplus by FY2015. Perhaps for the first time, a cap on the overall debt of the Government has been recommended. It has suggested a target of 68% of the GDP for the combined debt of the Centre and the States to be achieved by FY2015. Thus the fiscal consolidation path embodies steady reduction in the augmented debt stock of the Centre to 45% of the GDP by FY2015, and that of the States to less than 25% of the GDP by FY2015. The FC-XIII has also suggested the need for the FRBM Act to specify the nature of shocks that would require a relaxation of targets under the Act. It has recommended that the share of States in the net proceeds of shareable Central taxes be 32% in each of the financial years from FY2011 to FY2015. On the goods and services Tax (GST), the FC-XIII has proposed sanction of Rs. 500 billion as compensation for revenue losses of States on account of the implementation of the GST. This amount would shrink to Rs. 400 billion were the implementation to take place on/after April 1, 2013 and further to Rs. 300 billion were it to take place on/after April 1, 2014.

Credit and Monetary Issues

- The Economic Survey 2009-10 states that during 2009-10, the banking system's credit to the Government was the major driver of growth in broad money (M3). The increase in government's borrowing programme to finance expansionary fiscal response to the economic slowdown was the underlined reason. However M3 growth has shown signs of deceleration after September 2009. Among the sources of M3, bank credit to the commercial sector, which had been decelerating since October 2008 has shown a revival since November 2009. During 2009-10, bank credit recorded an increase of 8.4% (end March to January 2010). As against this, bank deposits recorded an increase of 10.7% during the same period. This has resulted in a decline in the credit-deposit(C-D) ratio which fell down 72.4 in end March 2009 to 70.9 on January 15, 2010.

- ❑ Net RBI credit to the Central Government increased by Rs. 29,638 crore during the financial year (up to January 15, 2010). This was mainly on account of unwinding of Market Stabilisation Scheme (MSS) balances and open market operations of the Reserve Bank of India (RBI), offset by increase in the cash balances of the Central Government and reverse repo operations. On year-on-year basis, increase in the net RBI credit to the Central Government as on January 15, 2010, was Rs. 119,895 crore as against an increase of Rs. 127,184 crore during the corresponding period a year ago. On a (yoy) basis, as on January 15, 2010, the growth of currency with the public was marginally higher at 17.3% as compared with 17.2% on the corresponding date a year ago. During the same period, growth in demand deposits accelerated to 19.8% as compared with a decline of 0.8% a year earlier.
- ❑ The accommodative monetary policy stance adopted by the RBI, post-September 2008, in response to the global financial crisis, continued during 2009-10. However, growth in bank credit remained low during 2009-10. The prevalent economic conditions as well as the cost of funds appear to have contributed to the slowdown in non-food bank credit from the banking sector. In addition, banks also reined in credit to the retail sector due to perceptions of increased risk on account of the general slowdown and to guard against bad loans. While the overall credit demand of the manufacturing sector from the banking sector slowed down during the 2009-10, corporates could access non-bank domestic sources of funds and external financing (which had almost dried up earlier during the crisis period) at lower costs. Thus, while bank credit during 2009-10 continued to decelerate, there was a turnaround in financing from non-bank domestic sources. It is likely that revival of growth in bank credit would manifest in the near-term economic recovery process.
- ❑ The survey has noted a general decline in benchmark prime lending rates (BPLRs) of commercial banks. However, the movement in the BPLRs does not fully and accurately reflect the changes in effective lending rates as nearly two-thirds of banks' lending takes place at sub-BPLR rates. To address this anomaly, the RBI announced the constitution of the Working Group on BPLR in its Annual Policy Statement of 2009-10 to review the system and suggest changes to make credit pricing more transparent. The Working Group has recommended replacing the existing BPLR system with a base rate system. With the proposed base rate system, banks will not need to lend below the base rate as it would represent the bare minimum rate below which it would not be viable for them to lend. The actual lending rates charged to borrowers could work out to be the base rate plus borrower-specific charges that would include product-specific operating costs, credit risk premium and tenor premium.

Infrastructure Issues

- ❑ The Survey has noted that core industries and infrastructure services, led by the robust growth momentum of telecom services and spread across power, coal and other infrastructure like ports, civil aviation and roads have shown signs of recovery with the pick-up in overall industrial growth, and easing of supply bottlenecks in certain sectors along with recovery of demand in others.
- ❑ The Survey has emphasised the need to develop infrastructure to compliment and sustained the economic growth momentum. The legislative, administrative and executive efforts are on to minimize the infrastructure deficit, ameliorate bottlenecks in completion of projects and nurture core industrial intermediates and infrastructure services, the Economic Survey adds. In line with,

the stimulus measures announced by the National Authorities worldwide to combat the economic slowdown, the Union Budget for 2009-10 substantially increased allocation for many infrastructure sectors over the Budget estimates for the previous year's especially for National Highways Development Programme (NHDP), Jawaharlal Nehru National Urban Renewal Mission (JNNURM) and Accelerated Power Development and Reform Programmes (APDRP).

- The Survey has noted that the recent economic downturn reinforced the need for enhancing infrastructure investment for greater productivity and growth. However, attracting private capital through PPP is neither easy nor automatic. A key pre-requisite is to lay down a policy, legal and regulatory framework that assures a fair return for investors, protects the interests of users, especially the poor, and assures quality supply at reasonable cost. For this purpose, it has noted that it is important that issues relating to the overarching PPP policy, incorporating inter alia the models to be used, contract documents to be adopted, procurement strategies and templates to be employed and mechanisms for financial structuring to be considered, are clearly outlined ab initio at the level of the sponsoring agencies, including State Governments.

DOMESTIC OUTLOOK

RBI's Survey of Professional Forecasters, February 2010

In February 2010, 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 upward to 6.9% in 2009-10, compared with 6% in the November 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 43.8% is assigned to growth range of 6.5-6.9% for 2009-10. For FY2011, they have assigned highest probability of 33.8% to 8.0-8.4% growth range for GDP. Real GDP growth from agriculture is forecast at -0.9% (-1.4% in November 2009) in FY2010. By comparison, the Central Statistical Organisation (CSO) has forecast real GDP from agriculture, forestry, and fishing to decline 0.2% in FY2010. For FY2010, growth forecast for industry has been revised upwards from 6.3% in the last survey to 8.4% in the current survey (compared with 6.6% in H1FY2010). The forecast for services sector for FY2010 has been revised downwards from 8.1% to 8.7% (compared with 8.3% in H1FY2010).
- The proportion of domestic saving to GDP is forecast at 35% in FY2010, revised upwards from 33.6% in the last (November 2009) survey. Forecasters expect GDCF to contribute 37.7% of real GDP in FY2010, up from 37.3% in last survey). GFCF's contribution to real GDP has also been revised upwards from 33.5% to 34%. The forecasters have predicted PFCE to grow at 6% in FY2010, revised downwards from 7% in the last survey.
- The profit growth of corporate sector in FY2010 has been revised upwards from 10% in the last survey to 11.3%. The growth is expected to recover to 18% (14.5% in the last survey) in FY2011. Corporate after-tax profit in Q4FY2010 is expected to increase 19%, revised upwards from previous survey forecast of 12%.
- Broad money (M3) growth is revised downwards to 18.3% for FY2010, from the earlier forecast of 19%. In FY2010, bank credit is expected to grow at the rate of 15% against previous forecast of 17%.

- On a quarterly basis, real GDP is expected to grow at 6.5% in Q3FY2010 (actual of 6%), 7.5% in Q4FY2010, and 7.9% in Q1FY2011. Contribution of GFCF to GDP has been projected at 35.4% in Q4FY2010, with a subsequent increase to 35.6% in Q1FY2011.
- Forecasters' median estimates for WPI inflation on a (yoy) basis in Q4FY2010 and Q1FY2011 are at 8.2% and 7.4%, respectively.

Results of Survey

	Actuals			Forecast (Median)		
	Q2 FY2010	Q3 FY2010	Q4 FY2010	Q1 FY2010	Q2 FY2011	Q3 FY2011
Real GDP growth rate at factor cost (per cent)	7.9	6.0	7.5	7.9	7.7	8.2
Agriculture & Allied Activities	0.9	-2.8	-0.9	2.0	3.0	4.7
Industry	9.1	12.8	10.0	9.0	8.4	8.3
Services	8.9	6.6	8.9	9.3	9.1	9.0
IIP growth rate	9.1	13.1	10.0	8.6	7.4	7.8
Private Final Consumption Expenditure (growth rate)	5.5	3.4	9.0	10.0	10.5	10.5
Gross Fixed Capital Formation (per cent of GDP at current market price)	34.1	31.7	35.4	35.5	37.0	36.5
Corporate profit after tax (growth rate)			19.0	18.5	18.5	22.0
US\$/INR (end period)	48.0	46.7	45.5	45.3	44.9	44.7
BSE INDEX (end period)	16,338	17,465	17,850	18,200	18,500	18,500
Export (US\$ billion)	39.85	41.00	45.7	44.3	46.6	47.7
Import (US\$ billion)	62.82	69.64	72.5	75.3	80.4	84.0
Trade Balance (US\$ billion)	-22.97	-28.64	-29.7	-28.8	-31.9	-36.4
Oil Price (in US\$/bbl)	68.2	75.5	80.0	78.5	80.0	79.0
WPI (yoy change)	-0.1	4.5	8.2	7.4	6.4	5.5
CPI-IW (yoy change)	13.9	16.4	11.3	11.4	7.9	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 had been a pause in India's long economic upswing. 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 in 2010. 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 and a recovery of world trade—business investment is expected to rebound. This should eventually feed through to stronger consumption and the economy should regain momentum in 2010. 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.

Industry and Economic Update has been prepared by ICRA Management Consulting Services Limited (IMaCS) for the Confederation of Indian Industry (CII).

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