

December 12, 2011

Economic Weekly



Indian Economy

***IIP At 31-Month Low:** India's industrial output in October contracted 5.1% from a year ago to hit the lowest level since March 2009. The fall in the Index of Industrial Production in October is alarming and should come as a wake-up call for policy makers who have so far ignored the weakness in the industrial sector. Industrial output fell in October because of contraction in mining and manufacturing output. Mining sector output has been negative for some time now, but it's the sharp fall in manufacturing output in October that resulted in contraction in overall industrial output during the month. Only electricity output grew, albeit lower from previous month. With slowing industrial activity, GDP growth could get further impacted.

***Easing Inflation To Give Policy Relief:** After exhausting all possible monetary tools, decline in primary articles inflation is a thing to cheer about. Overall inflation is likely to ease further because of a high base and fall in food prices, and lower inflation rate will help RBI take steps to boost economic growth. We expect the central bank to leave rates unchanged in the mid-quarter monetary policy meet on Friday. Also, we expect the sharp fall in industrial output in October to come as a wake-up call.

***WPI Primary Articles Inflation Eases:** Primary articles inflation in the week ended November 26 stood at 6.92% on a year-on-year basis compared with 7.74% in the previous week. Primary articles inflation eased because of fall in prices of food articles during the week. Primary articles index declined 0.55% on a week-on-week basis. Food inflation eased to 6.60% from a year ago, compared with 8% in the previous week.

***Forex Reserves Rise By \$2.5 billion:** Foreign exchange reserves rose by \$2.5 billion to \$306.8 billion in the week ended December 3, largely due to a rise in foreign currency assets and gold prices.

***Currency Trends:** Currency trends of major currencies and expectations for the coming week.

Global Economy

***European Leaders Agree On Fiscal Pact:** Last week, at a summit meeting in Brussels, European leaders agreed on a comprehensive plan to end the debt crisis. The agreement among European Union nations calls for tougher fiscal rules that can end the present debt crisis and also prevent a crisis in the future. The UK disagreed with proposals while Germany was in favour of a pact that authorises European Commission and European Court of Justice to implement the rules.

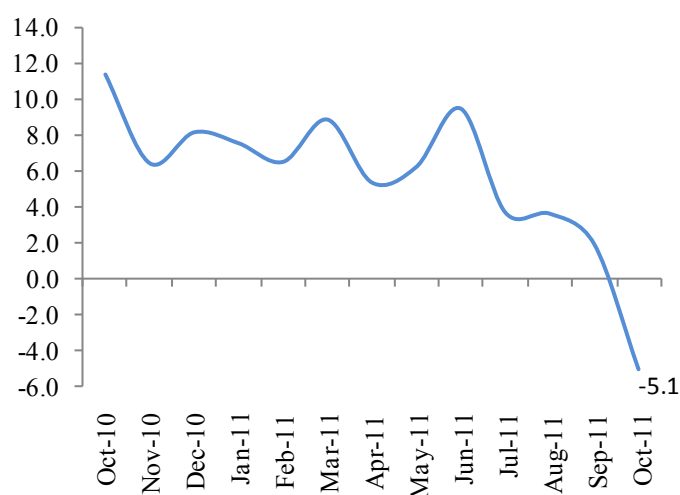
Table of Contents	Page
IIP for October	2
Mid-Quarter Monetary Policy Expectations	4
WPI Primary Articles	6
Forex Reserves	8
European Leaders Agree On Fiscal Pact	9
Currency Trends	10

Industrial Output Shrinks 5.1% in Oct Vs Year Ago Number

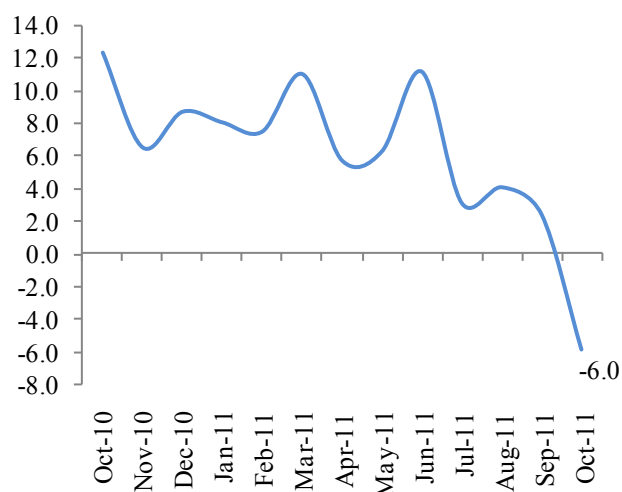
India's industrial output in October contracted 5.1% from a year ago to hit the lowest level since March 2009. The fall in the Index of Industrial Production in October is alarming and should come as a wake-up call for policy makers who have so far ignored the weakness in the sector. Industrial output fell in October because of contraction in mining and manufacturing output. Mining sector output has been negative for some time now, but it's the sharp fall in manufacturing output in October that resulted in contraction in overall industrial output during the month. Only electricity output grew, albeit lower from previous September. With slowing industrial activity, gross domestic product growth could get further impacted. In the mid-year economic review that was released by the Union finance ministry on Friday, the government expects 2011-12 (April-March) GDP growth at 7.25-7.75%, which seems rather optimistic given the current slump in industrial activity.

- ◆ **IIP At 31-Month Low:** Industrial output fell sharply in October due to a high base and contraction in output on a month-on-month basis. IIP contracted by 5.1% in October from a year ago against 1.9% growth in the previous month. IIP contracted 3.3% on a month-on-month basis. In April-October, IIP grew 3.5% from a year ago compared with 8.7% growth in the same period a year ago.
- ◆ **Output By Industry Groups:** Industrial output fell in October due to poor performance of mining and manufacturing sectors. Mining output further contracted to 7.2% on a year-on-year basis from 7.1% in September. Manufacturing, which accounts for 75.5% of the IIP index, was largely responsible for the drop in overall industrial output. Manufacturing output contracted for the first time this year in October by 6% on a year-on-year basis as against expansion of 2.4% a month before. Electricity registered a growth of 5.4% compared with 9% growth in the previous month.
- ◆ **Sector-wise Performance:** Industrial output weakened across all sectors in October. Basic goods output contracted 0.1% in October from a year ago, against 4% expansion in September. Capital goods output shrank 25% compared with 6.5% contraction in the previous month. Intermediate goods output turned negative for the first time this financial year with the sector shrinking 4.7% in October against growth of 1.3% in September. Consumer goods output also turned negative for the first time this financial year, which indicates slowing demand. Consumer durables output contracted 0.3% against expansion of 9.3% in the previous month. Consumer non-durables goods output shrank 1.3% in October compared with 0.2% contraction a month ago.
- ◆ **Volatile Capital Goods Growth:** Capital goods growth has remained low and very volatile despite changes in its constituents. If capital goods index is correctly capturing underlying momentum, then it could be risk to growth in coming year too. However, given the volatility in the index a definitive conclusion cannot be arrived at the moment.

IIP (2004-05), % YoY



Manufacturing, % YoY (2004-05)

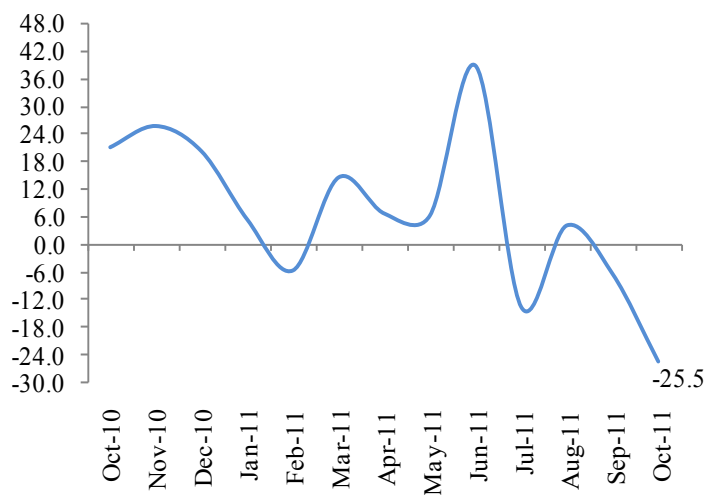


Monthly Trends

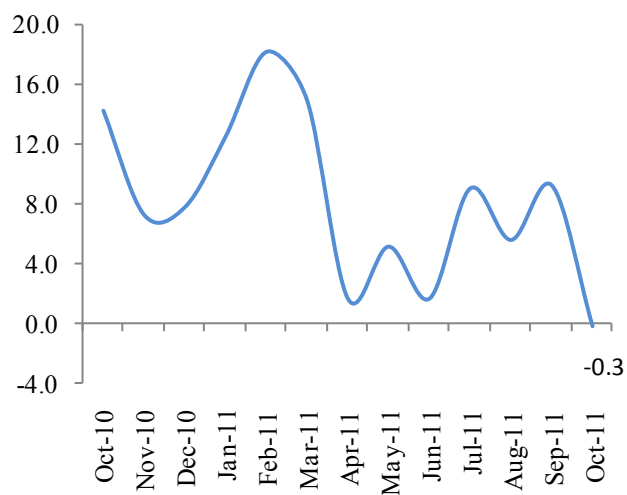
Index For Industrial Production (2004-05)

% YoY	Weight %	Oct-10	Jun-11	Jul-11	Aug-11	Sep-11	Oct-11
IIP	100	11.4	9.5	3.7	3.6	1.9	-5.1
Mining & Quarrying	14.2	6.1	-1.4	0.6	-4.1	-7.1	-7.2
Manufacturing	75.5	12.4	11.2	3.1	4.1	2.4	-6.0
Electricity	10.3	8.8	7.9	13.1	9.5	9.0	5.6
Basic goods	45.7	9.8	7.8	10.0	5.2	4.0	-0.1
Capital goods	8.8	21.0	38.7	-13.7	4.1	-6.5	-25.5
Intermediate goods	15.7	9.7	1.6	-0.1	1.9	1.3	-4.7
Consumer goods	29.8	9.4	3.1	6.4	2.3	4.3	-0.8
Consumer Durables	8.5	14.3	1.6	9.0	5.5	9.2	-0.3
Consumer Non Durables	21.3	5.1	4.4	4.1	-0.6	-0.2	-1.3

Capital Goods, % YoY



Consumer Durables, % YoY

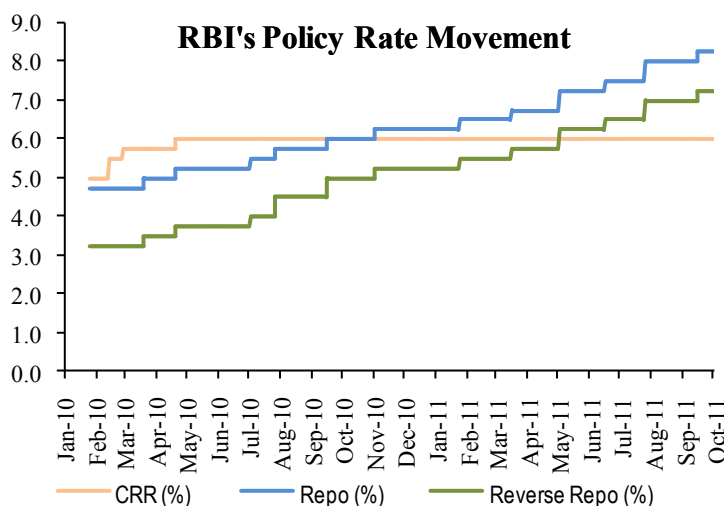


Easing Inflation To Give Policy Relief

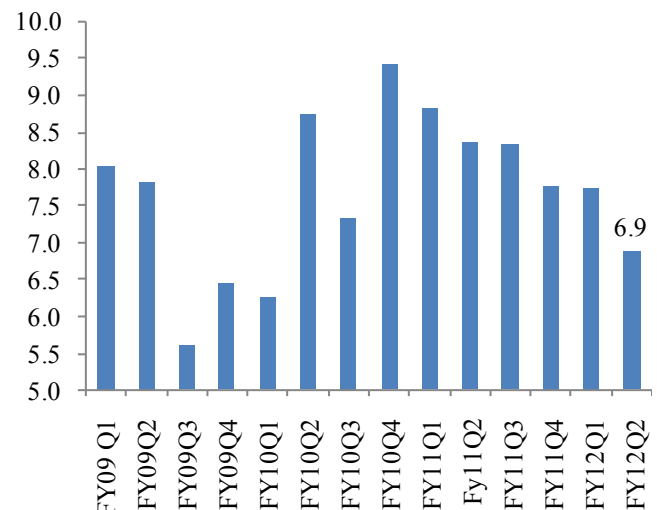
Latest inflation figures show food inflation easing to 6.6%. This is going to provide some relief to policy-makers. After exhausting all possible monetary tools, a decline in primary articles' inflation should bring some cheer. Overall inflation is likely to ease further because of a high base and fall in food prices, and lower inflation rate will help Reserve Bank of India take steps to boost economic growth. We expect the central bank to leave rates unchanged in the mid-quarter monetary policy meet on Friday (December 16). Also, we expect the sharp fall in industrial output in October to come as a wake-up call for policy-makers.

- ◆ **Monetary Policy Expectations:** We expect that the mid-quarter monetary policy meet on Friday (December 16) will mark a formal change of course in the RBI's anti-inflationary stance pursued so far. RBI is likely to keep policy rates unchanged at its Friday meet after 13 consecutive rate hikes over the past 22 months. With slowing growth, inflation is bound to decelerate as demand has started wearing off. With industrial output falling in October, monetary policy statement should focus on arresting declining growth. RBI is also expected to anchor currency expectations to end volatility in the currency market. Indian rupee has depreciated 17% since August. We expect RBI to announce measures and give a roadmap to assist growth going forward.
- ◆ **Weakening Industrial Activity:** With IIP contracting 5.1% in October from a year ago, slowdown apprehensions are now confirmed. We expect IIP to remain subdued in coming months. IIP in October is a reflection of poor growth momentum. Also, decline in consumer durables growth points to demand destruction. Slowing demand can impact services that constitute around 60% of GDP. In April-October, industrial output grew 3.5% from a year ago compared with 8.7% growth in the same period a year ago. Poor growth momentum is also visible from declining credit and money supply growth.
- ◆ **Decline In GDP Growth:** GDP growth for July-September printed at 6.9% on a year-on-year basis, indicating a slowdown in the economy. This slowdown has been broad-based. Given the inter-linkages industry has with other sectors, services growth is also expected to get impacted. GDP growth could decline further in coming quarters because of the slump in industrial activity. Finance ministry recently cut its growth estimate for this financial year to 7.25-7.75% from earlier 9%. Slowing economic growth is also going to impact fiscal health of the government. Parliament recently approved additional spending with second supplementary grant of ₹63,000 crore. With tax and non-tax mop-up falling far short of the budgeted targets, there can be a significant rise in fiscal deficit this year. Additional government borrowings could create additional policy complications for RBI.

RBI Policy Rate Movement



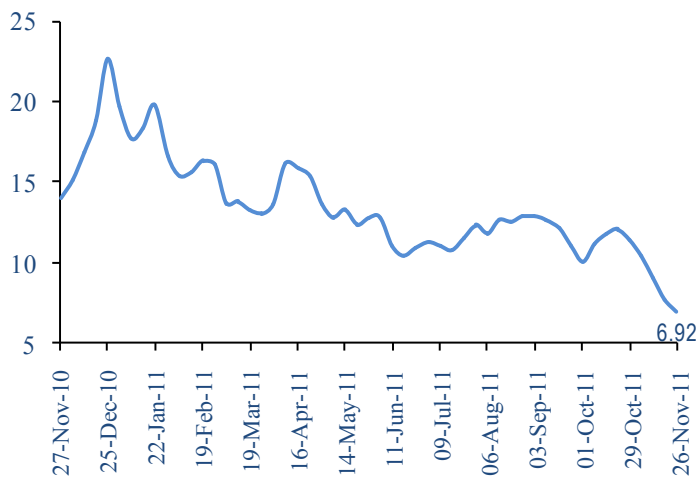
GDP Factor Cost, % YoY (2004-05)



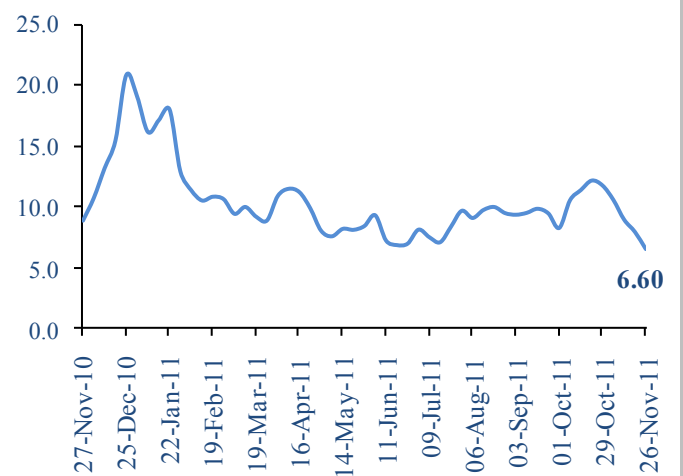
WPI Primary Articles Inflation

Wholesale Price Index inflation for primary articles for the week ended November 26 stood at 6.92% on a year-on-year basis compared with 7.74% in the previous week. Primary articles inflation eased because of fall in prices of food articles during the week. The index declined 0.55% on a week-on-week basis. Food inflation eased to 6.60% from a year ago, compared with 8% in the previous week.

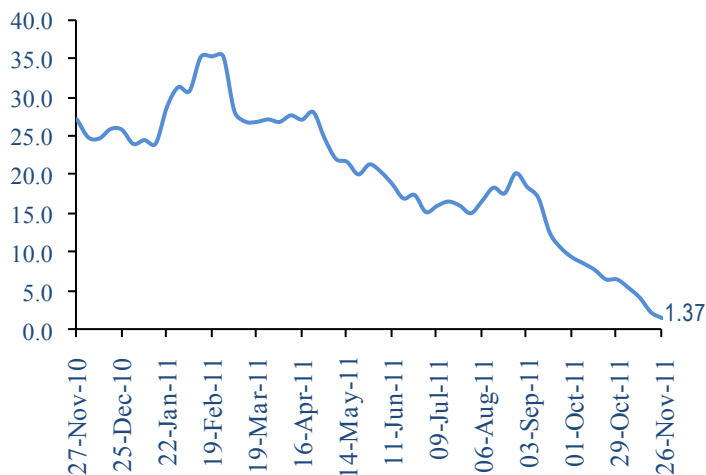
Primary Articles Inflation, % YoY



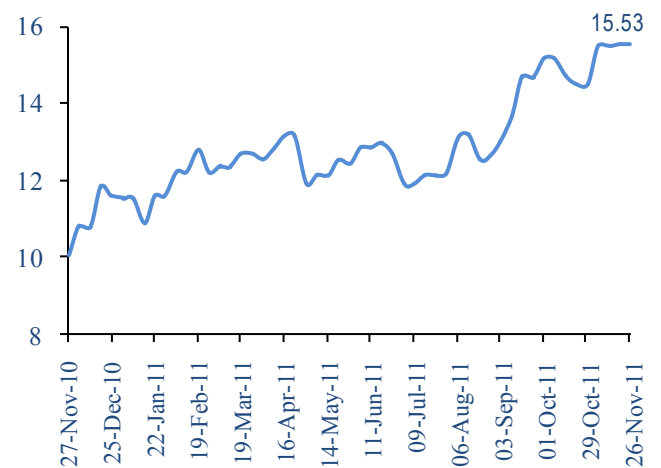
Food Inflation, % YoY



Non-Food Inflation, % YoY



Fuel Inflation, % YoY



Weekly Trends In Primary Articles Inflation

- ◆ Food inflation in the week ended November 26 stood at 6.60% on a year-on-year basis compared with 8.80% in the previous week. Food inflation slowed during the week due to food prices easing 0.97% from the week before. Food prices fell due to lower prices of jowar, condiments, poultry chicken and fruits and vegetables, among others.
- ◆ Non-food articles inflation stood at 1.37% on a year-on-year basis, compared with 2.14% a week ago, due to a high base despite rise in prices of non-food articles by 0.57% over the week. Non-food articles index rose due to higher prices of oilseeds.
- ◆ Minerals inflation eased to 19.06% from 16.26% in previous week, due to a low base despite no change in index.

WPI Sub groups	Index	% YoY	% YoY	% WoW	% WoW
	26-Nov-11	26-Nov-11	19-Nov-11	26-Nov-11	19-Nov-11
Primary articles	199.3	6.92	7.74	-0.55	-0.74
Food Articles	193.8	6.60	8.00	-0.97	-1.41
Non Food Articles	177.7	1.37	2.14	0.57	1.14
Minerals	311.1	19.06	16.26	0.00	0.19
Fuel	171.8	15.53	15.53	0.00	0.17

- ◆ Fuel inflation stood unchanged at 15.53% on a year-on-year basis in the week ended November 26, as there was no change in the index during the week.

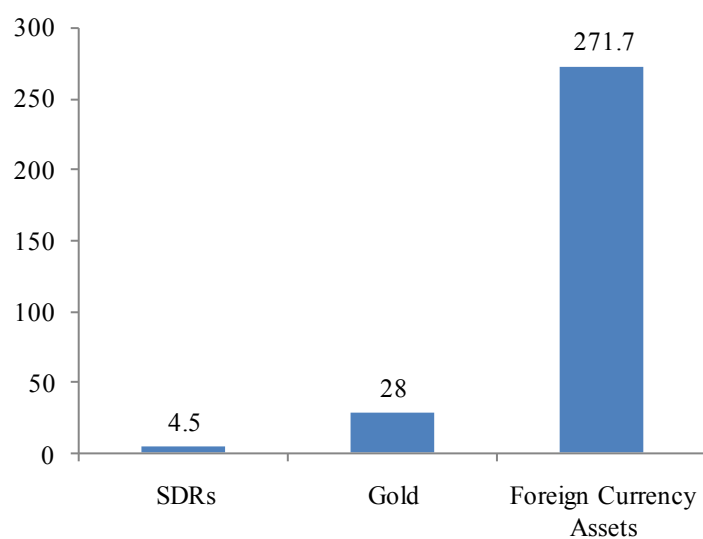
Forex Reserves Rise \$2.5 Billion

Foreign exchange reserves increased by \$2.5 billion to \$306.8 billion in the week ended December 3, largely due to a rise in foreign currency assets and gold prices. Total foreign exchange reserves comprise foreign currency assets, special drawing rights and central bank's position in gold, all of which are measured in US dollars.

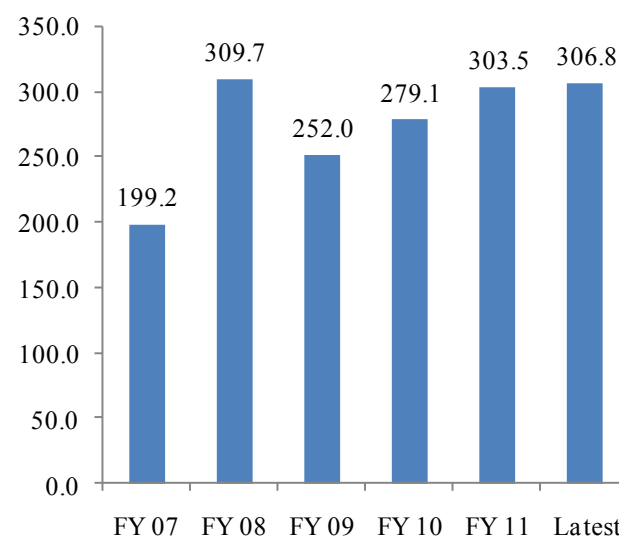
- ◆ In the week ended December 3, foreign currency assets increased \$2.5 billion to \$271.7 billion. Revaluation changes could have led to an increase in foreign currency assets.
- ◆ Position in gold increased by \$1.1 billion while reserve position with International Monetary Fund, special drawing rights (SDRs) remained largely unchanged during the week.

\$ bn	Forex Reserves	SDRs	Reserve Position In IMF	Gold	Foreign Currency Assets
12-Nov-11	314.3	4.5	2.6	26.9	280.3
19-Nov-11	308.6	4.5	2.6	26.9	274.6
26-Nov-11	304.4	4.5	2.6	26.9	270.4
03-Dec-11	306.8	4.5	2.6	28.0	271.7

Forex Reserves Components (in \$ billion)



Forex Reserves Annual Trends (in \$ billion)



European Leaders Agree On Fiscal Pact

Last week, at a summit meeting in Brussels, European leaders agreed on a comprehensive plan to end the euro-zone debt crisis. The agreement calls for tougher fiscal rules to end the present debt crisis and prevent another one in the future. UK disagreed while Germany was in favour of a pact that authorises European Commission and European Court of Justice to implement the rules.

- ◆ **EU Pact:** The agreement, which was finalised on Friday, was accepted by 26, out of 27, EU nations that agreed to centralisation of budgets and punishments for those which don't meet specific targets. The UK was the only country to vote against the pact. The talks that went on for 10 hours and discussed the possibility of emergency measures to save the currency union. Seventeen euro-zone countries formally agreed to run only minimal budget deficits in the future and gave their approval to allow the European Court of Justice the right to strike down national laws that don't enforce such discipline. The move is a major transfer of national sovereignty over budget policy.
 - ◆ **ECB Action:** European Central Bank President Mario Draghi discussed with EU finance ministers steps to resolve the debt crisis and how far the ECB should support the countries dealing with the situation. The size of euro-zone's rescue fund and the part to be played by IMF were other important points discussed at the meet. A Wall Street Journal report said EU leaders agreed to cap the European Stability Mechanism at 500 billion euro, and that EU nations would provide up to 200 billion euro in loans to the International Monetary Fund to increase its funding ability. Once last week's Brussels agreement is implemented, it can be expected that the ECB will buy large quantities of troubled sovereign debt and thereby restore market confidence and prevent the crisis from spiralling out of control. The quantitative easing can help the troubled EU nations.
 - ◆ **UK Isolated:** Other EU nations rejected UK's bid to have preferential treatment in the agreement. A proposal of intra-government treaty of 17 nations was proposed by France and Germany, and was supported by all nations, including the non-member EU nations, leaving Britain isolated.
 - ◆ **German's Perspective:** Germany has long held the view that only by enforcing stricter budget discipline and penalties the EU can survive. These measures can prevent future crises only by reforms and strict adherence to fiscal principles. Germany has opposed possibility of utilising ECB for bailouts. This is one reason that IMF route for bailouts has been preferred to enforce discipline among nations facing debt crisis.
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Currency Trends

	USD-INR	EUR-USD	GBP-USD	USD-JPY
Open:	52.27	1.3435	1.5631	78.00
High:	52.35	1.3486	1.5770	78.10
Low:	51.23	1.3280	1.5559	77.13
Close:	52.03	1.3379	1.5650	77.66

INR/USD:

Last week, rupee traded in range of ₹51.20–52.35 versus dollar. This week, we expect the Indian rupee to trade in ₹51.75-52.90 range.

Rupee's weekly support and resistance are as follows for this week:

Resistance 1:	52.5100	Support 1:	51.3800
Resistance 2:	52.9900	Support 2:	50.7400

EUR/USD:

Weekly support and resistance for the rupee versus the dollar are as follows for this week:

Resistance 1:	1.3483	Supports 1:	1.3277
Resistance 2:	1.3588	Support 2:	1.3176

GBP/USD

Weekly support and resistance for the pound sterling versus dollar are as follows for this week:

Resistance 1:	1.5760	Supports 1:	1.5549
Resistance 2:	1.5871	Support 2:	1.5449

USD/JPY

Weekly support and resistance for the dollar versus the yen are as follows for this week:

Resistance 1:	78.1300	Supports 1:	77.1600
Resistance 2:	78.6000	Support 2:	76.6600



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