

July 25, 2011

Economic Weekly



Indian Economy

* **RBI policy meet tomorrow:** We expect RBI to raise interest rates by 25 bps in the monetary policy meet tomorrow as inflation continues to remain elevated. We expect RBI to give clear guidance on the interest rate regime tomorrow in light of recent slowdown in credit off take and IIP growth. However, as food inflation is easing, while credit & industrial growth are moderating, it's expected that the interest rate cycle will peak soon.

* **Food inflation dips to a 2-year low:** Food articles inflation dipped to a two-year low of 7.58% YoY compared with 8.31% YoY a week ago in the week ending July 9, 2011, largely due to favorable high base effect. Primary articles inflation also eased to 11.13% YoY compared with 11.58% YoY a week ago.

* **Forex reserves declined marginally:** Forex reserves decreased to \$314.5 billion in the week ending July 16, 2011, due to a marginal fall in foreign currency assets.

* **Currency Trends:** Highlights of currency and Nifty movements last week.

Global Economy

* **Greece bailed out again:** Greece received its second massive bailout of 159 billion Euros (\$228 billion) from the Euro nations. The second bailout within a year has raised concerns about the stability and risk within the Euro Zone. The bailout entails 109 billion Euros to be contributed by Euro nations and the remaining 50 billion Euros will be provided by private banks and financial institutions. The bail-out, though welcomed by Euro nations, was criticized by the President of the German central bank and an ECB board member. Moody's downgraded Greece debt rating further to Caa1. Moody has cut Greece rating five times since December 2009 from A1. Caa1 is four steps above Moody's lowest rating.

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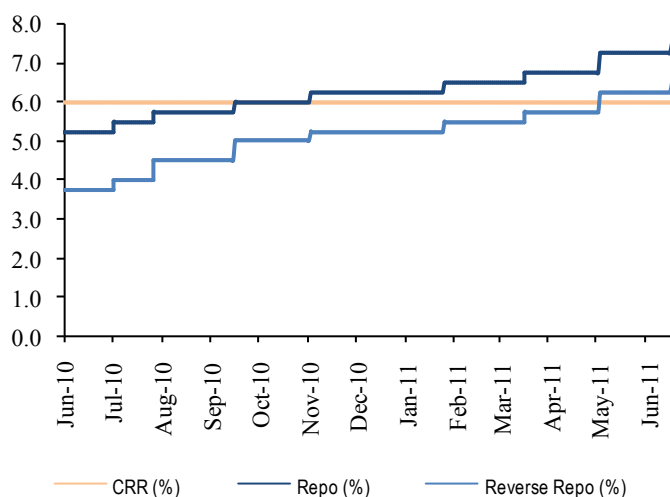
RBI Monetary Policy Meet Tomorrow:

Rate Hike Likely In Coming RBI Policy Meet on July 26, 2011: As inflation continues to rise and given the RBI's anti inflationary stance, we expect a 25 bps hike in benchmark rates in the monetary policy meet on July 26, 2011. Going by the past revisions in the inflation rate, and the extent of the revisions, it seems inflation is already close to double digits levels.

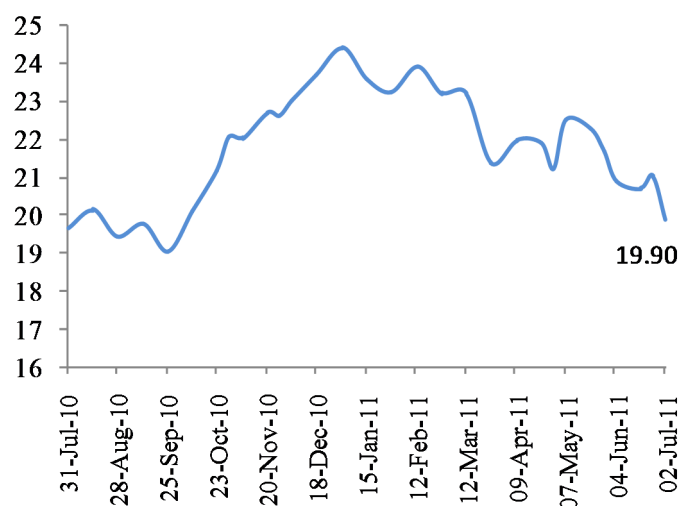
Interest Rate Cycle Nearing Inflection: Even though WPI inflation continues to be high, the recent easing of food articles inflation and slower credit and industrial growth can lead to an end of the interest rate tightening cycle soon. As inflation is largely import led, it is being felt that increasing interest rates in the domestic economy may not bear results. We expect RBI to give clear guidance on interest rates regime tomorrow in light of recent slowdown in credit off-take and IIP growth. We expect cycle of interest rate hikes to end with a probable 25 bps more hike in September 2011. This is assuming that oil prices do not spike from current levels.

Rate Hike in Last one year: RBI has increased interest rates 8 times in last one year. Benchmark policy interest rates have increased by 225 bps in this one-year period.

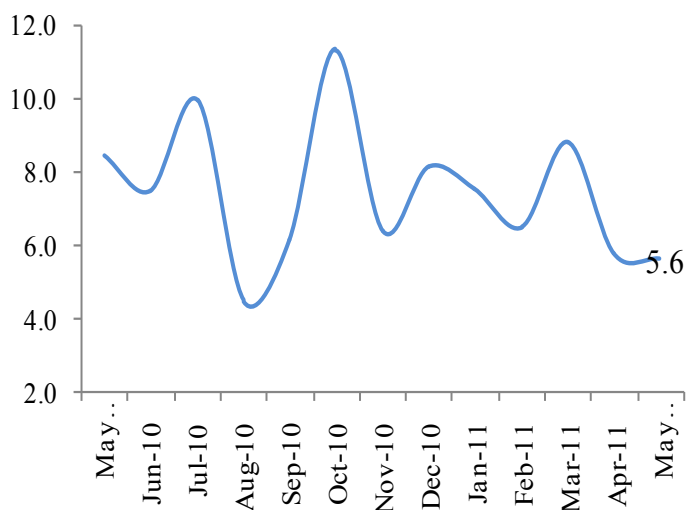
RBI Policy Rate Movement



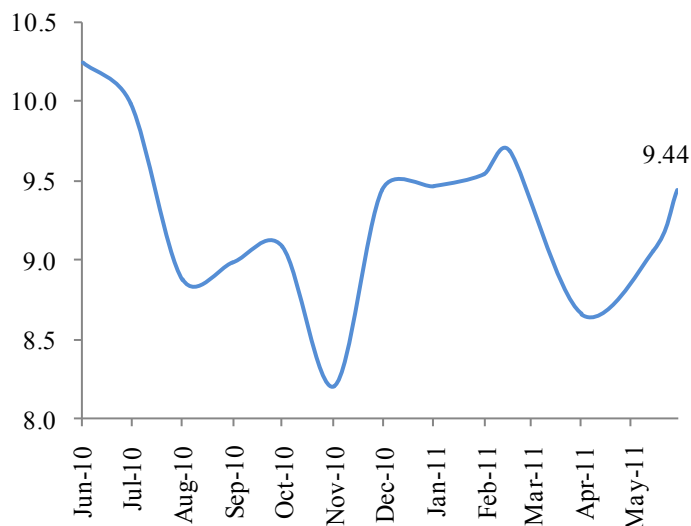
SCB Credit Growth, % YoY



IIP Growth New Series, % YoY



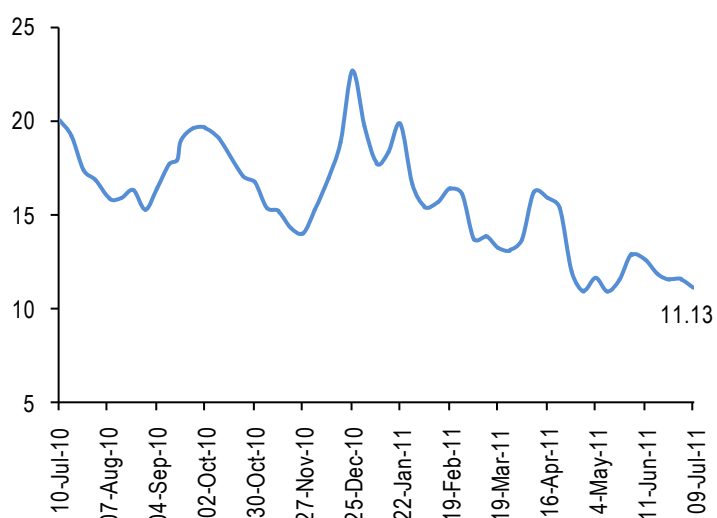
WPI Inflation, % YoY



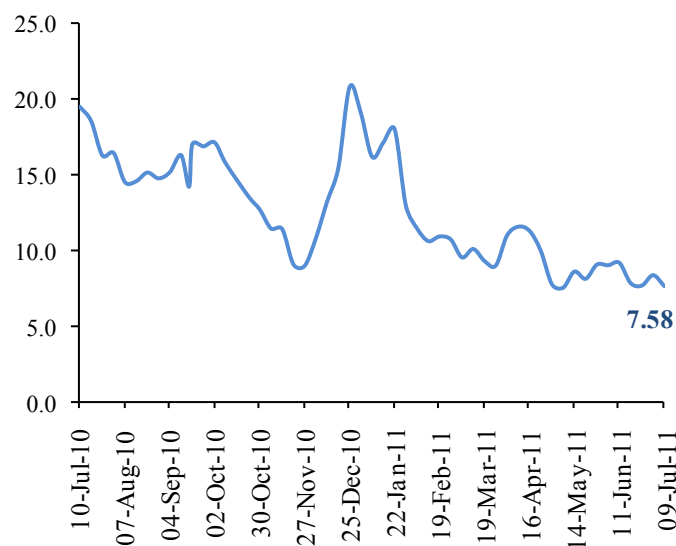
Food Inflation at a two year low of 7.58% YoY

Food articles inflation dipped to a two-year low of 7.58% YoY compared with 8.31% YoY a week ago, in the week ending July 9, 2011, largely due to a favourable high base effect. In the past few weeks, food inflation has declined both due to a high base effect and easing of prices of fruits and vegetables. Primary articles inflation also eased to 11.13% YoY compared with 11.58% YoY a week ago due to a high base, despite a rise in index by 0.05% WoW.

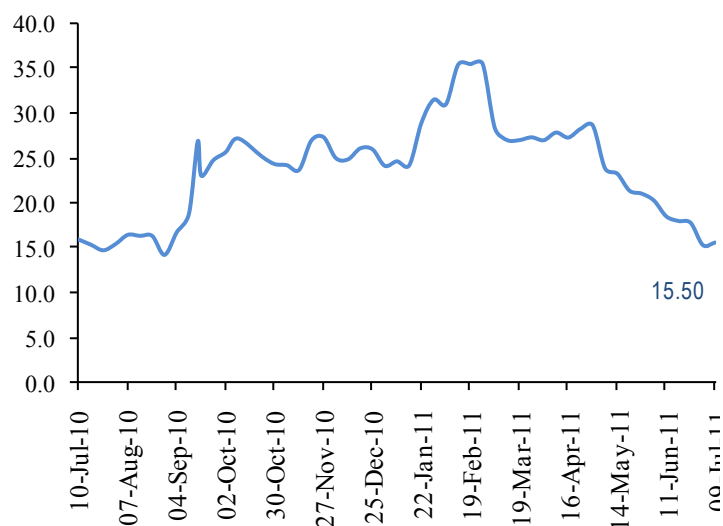
Primary Articles Inflation, % YoY



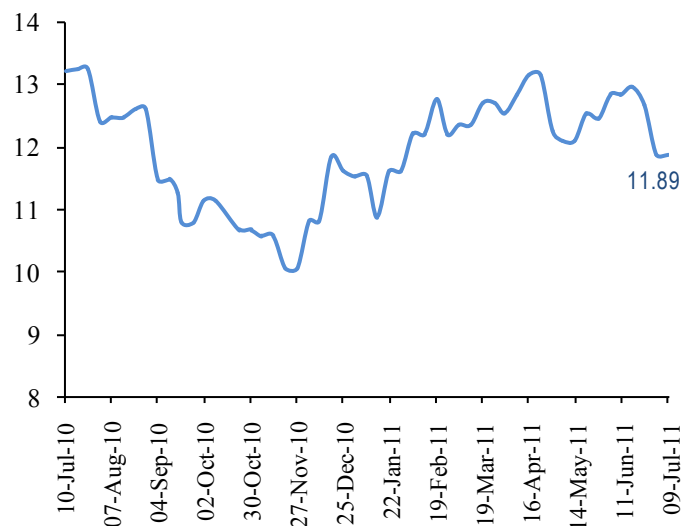
Food Inflation, % YoY



Non Food Inflation, % YoY



Fuel Inflation, % YoY



Trends in Primary Articles Inflation

- ◆ Food inflation eased to 7.58% YoY compared with 8.31% YoY a week ago due to a high base. During the week, food index remained unchanged.
- ◆ Non food inflation increased to 15.50% YoY compared with 15.20% YoY a week ago due to marginal increase in the index 0.06% WoW.
- ◆ Mineral index remained unchanged during the week. Mineral inflation stood 27.87% YoY higher from 27.82% YoY a week ago.

WPI Sub groups	Index	% YoY	% YoY	% WoW	% WoW
	09-Jul-11	09-Jul-11	02-Jul-11	09-Jul-11	02-Jul-11
Primary articles	197.7	11.13	11.58	0.05	-0.42
Food Articles	191.7	7.58	7.78	0.00	0.47
Non Food Articles	175.9	15.5	15.2	0.06	-2.12
Minerals	314.7	27.87	27.82	0.00	0.00
Fuel	165.6	11.89	11.89	0.00	-0.42

Fuel inflation remained unchanged at 11.89% YoY as there was no change in the index during the week.

Forex Reserves Decline To \$314.5 billion

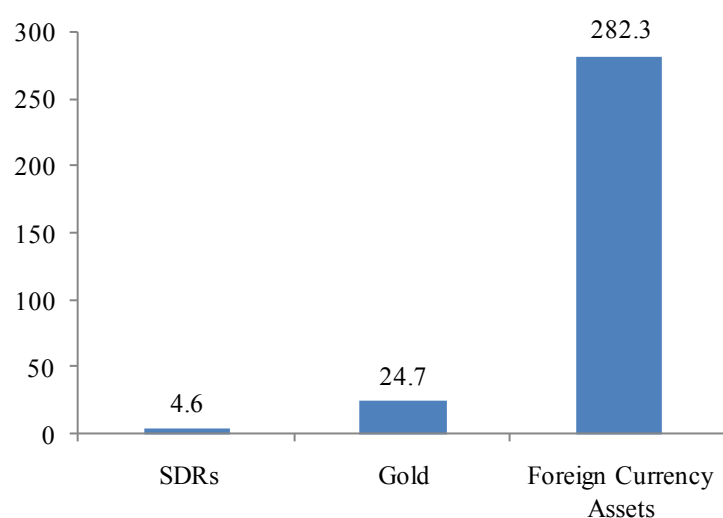
Forex reserves decreased to \$314.5 billion in the week ending July 16, 2011, due to a fall in foreign currency assets. During the week, forex reserves declined marginally by \$0.1 billion to \$314.5 billion.

Total forex reserves comprise foreign currency assets, SDRs and the central bank's position in gold, all of which are measured in US dollars.

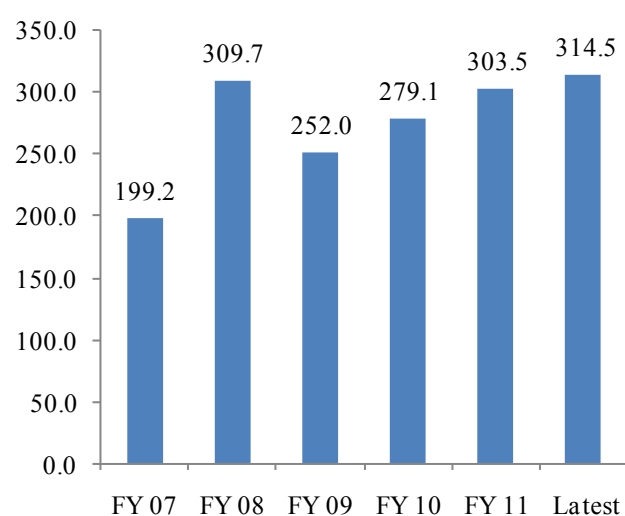
- ◆ During the week ending July 16, 2011, foreign currency assets declined by \$0.1 billion to \$282.3 billion due to revaluation changes which led to decline in the overall position in forex reserves.
- ◆ Positions in gold and reserve position with IMF and SDRs remained unchanged during the week.

US\$ bn	Forex Reserves	SDRs	Reserve Position in IMF	Gold	Foreign currency assets
25-Jun-11	309.0	4.6	3.0	24.4	277.1
02-Jul-11	315.7	4.6	3.0	24.7	283.5
09-Jul-11	314.6	4.6	3.0	24.7	282.4
16-Jul-11	314.5	4.6	3.0	24.7	282.3

Forex Reserves Components (in \$ billion)



Forex Reserves Annual Trends (in \$ billion)



Greece Bailed Out Again:

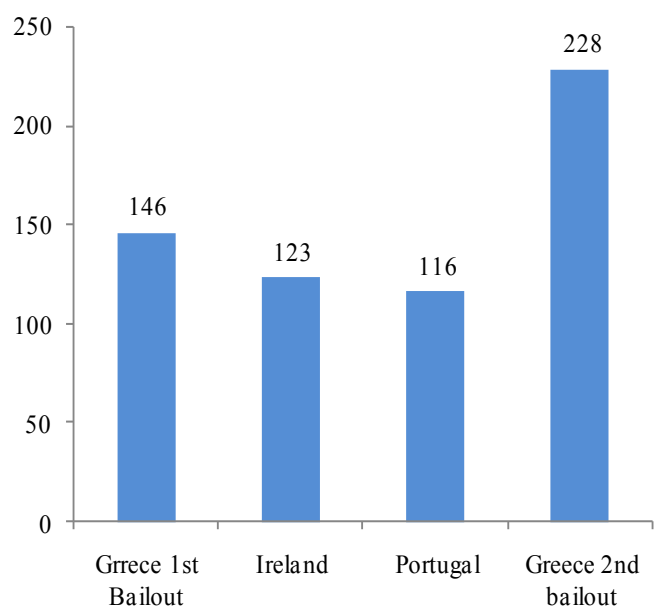
Greece received a second massive bailout of 159 billion Euros (\$228 billion) from the Euro nations. The second bailout within a year has raised concerns on the stability and the risk within the Euro Zone.

- ◆ The bail-out entails 109 billion Euros to be contributed by the Euro nations and the remaining 50 billion Euros will be provided by private banks and financial institutions.
- ◆ The bailout though welcomed by Euro nations also received criticism. Jens Weidmann, president of the German central bank, Bundesbank, warned that “By transferring sizeable additional risks to aid-granting countries and their taxpayers, the euro area made a large step toward a collectivization of risks in case of unsolid public finances and economic mistakes. That’s weakening the foundations of a monetary union founded on fiscal self-responsibility. In the future, it will be even more difficult to maintain incentives for solid fiscal policies”.
- ◆ Lorenzo Bini Smaghi, a member of the European Central Bank’s executive board, criticized Greece bailout , arguing that it raises the risk of a contagion within the Euro zone and weakened the common currency.
- ◆ Moody’s downgraded Greece’s debt rating further to Caa1. Moody has cut Greece rating five times since December 2009 from A1. Caa1 is four steps above Moody’s lowest rating.
- ◆ Bail-out terms include strict adherence to fiscal targets. All countries under bailout have to reduce fiscal deficit to 3% of GDP by 2013.

Time Line of Bailouts

- ◆ **Greece First Bailout– May 2010**
- ◆ **Ireland Bailout– Nov 2010**
- ◆ **Portugal Bailout– May 2011**
- ◆ **Greece Second Bailout– July 2011**

Euro Zone Bailouts in \$ bn



Currency and Nifty Movement

	USD/INR	EUR/INR	NIFTY
Open:	44.600	62.808	5581.75
High:	44.605	64.105	5645.40
Low:	44.350	62.376	5532.70
Close:	44.350	63.903	5633.95

USD/INR:

Last week, INR continued to be in range of 44.30-44.60. For this week, we expect INR to trade in a range of 44.20-44.70. Support at 44.35 levels need to watched carefully.

INR Weekly Support and Resistance are as follows for the coming week:

Resistance 1:	44.5200	Support 1:	44.2600
Resistance 2:	44.6900	Support 2:	44.1800

EUR/INR:

Last week, EUR/INR traded in a volatile range of 62.3500– 64.15. For this week, we expect the pair to trade in a range of 62.50 – 64.50.

EUR/INR Weekly Support and Resistance are as follows for the coming week:

Resistance 1:	64.5500	Support 1:	62.8200
Resistance 2:	65.5500	Support 2:	61.7300

NIFTY

Last week, Nifty traded in a range of 5650.05 – 5530.00. For this week, we expect the pair to trade in a range of 5550 – 5750.

NIFTY Weekly Support and Resistance are as follows for the coming week:

Resistance 1:	5675.33	Support 1:	5562.63
Resistance 2:	5716.72	Support 2:	5491.32

Factors that impacted the markets last week:

- ◆ US Debt Crisis: Dollar Negative – Euro Positive
- ◆ Europe Bailout: Dollar Negative – Euro Positive



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