January 9, 2012

Economic Weekly

Policy & Research Unit

DhanlaxmiBank
established 1927

Economic Weekly

Indian Economy

***Inflation Slowing:** Sharp slowdown in WPI food inflation witnessed recently is likely to put brakes on overall headline inflation that has been surging for two years. We expect WPI inflation in December could ease to around 7.5% on a year-on-year basis. Latest WPI food inflation in the week of December 24 turned negative at 3.36% on a year-on-year basis due to high base and decline in food articles prices. Inflation entering a high base period can result in the rate going deeper into negative territory going forward. Easing inflation levels may provide RBI room to cut high interest rates. The last mid-quarter monetary policy had explicitly hinted at easing of rates provided inflation rate declines on expected lines. If inflation decelerates at a pace faster than what RBI expects, then it is possible the central bank will cut rates in the next monetary policy due on January 24. However, RBI's decision will also depend on crude oil prices and stability of rupee.

***Sector-wise Deployment Of Credit:** Gross bank credit growth for November stood lower at 17.2% on a year-on-year basis compared with 22.3% in the same month a year ago. Non-food credit growth stood lower at 16.8% in November compared with 22.1% a year ago. Credit growth to industry came down to 20.9% in November from 27% a year ago led by decline in loans taken by large industries. Credit growth to services also stood lower at 16.9% compared with 22.5% a year ago. Scheduled commercial banks' lending to priority sector also saw lower growth at 9.2% compared with 21% a year ago.

***WPI Primary Articles Inflation Eases:** Primary articles inflation in the week ended December 24 stood at 0.10% on a year-on-year basis compared with 2.70% in the previous week. Primary articles inflation eased because of fall in prices of food articles during the week. Food inflation turned negative for the first time in six years and stood at a negative 3.36% on a year-on-year basis, against 0.42% in the previous week.

***Forex Reserves Fall Further:** Foreign exchange reserves fell further by $4.5 billion to $296.3 billion in the week ended December 31, largely due to a decline in foreign currency assets and gold.

***Speech By RBI Official:** RBI Executive Director V.K. Sharma recently delivered a speech in Bangalore on 'Financial Market Volatility And The Risk Management Imperative'.

Global Economy

***China To Assist Growth:** China is expected to support growth further. Chinese Premier Wen Jiabao last week asserted that they would fine-tune monetary policy to support growth conditions in that country. China may bring down required reserve ratio further after the recent cut to infuse liquidity in the system.

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Inflation Slowing

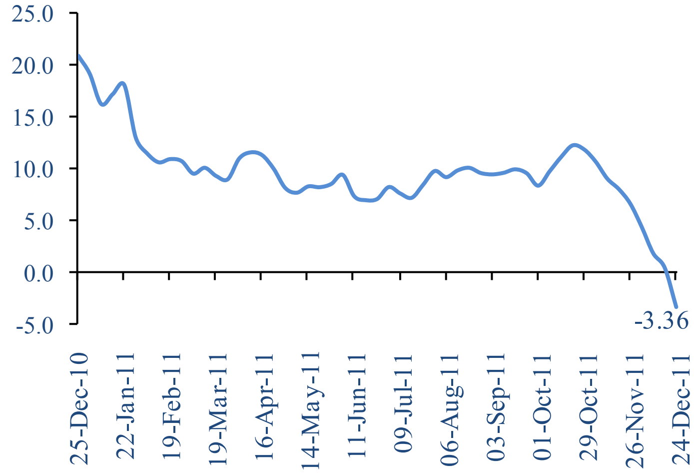
Sharp slowdown in Wholesale Price Index food inflation witnessed recently is likely to bring down the runaway overall headline inflation of the past two years. We expect WPI inflation in December could ease to around 7.5% on a year-on-year basis. Latest WPI food inflation in the week of December 24 turned negative at 3.36% on a year-on-year basis due to high base and decline in prices of food articles. Food inflation entering a high base period can result in the rate going deeper into negative territory going forward. Easing inflation levels may provide RBI room to cut high interest rates. The last mid-quarter monetary policy had explicitly hinted at an easing of monetary policy provided inflation slows along expected lines. If inflation decelerates at a pace that is faster than what the RBI expects, then there is a possibility of a rate cut on January 24 itself, when the next monetary policy review is due. However, RBI's rate decision will also depend on crude oil prices and stability of rupee versus the dollar.

- **Primary Articles Inflation Near Zero:** Primary articles inflation eased to a low of 0.10% on a year-on-year basis in the week ended December 24. The decline has been led by sharp slowdown in both food and non-food inflation. Food inflation in the week needed December 24 turned negative at 3.36% while non-food articles inflation eased to 0.80% compared with a year ago. High base and easing of food prices led to decline in primary articles' inflation. The high base period will continue and will impact headline inflation significantly going forward. In December 2010, food inflation had climbed as high as around 20% on a year-on-year basis while non-food inflation scaled 25% levels, which led to spike in overall WPI inflation.

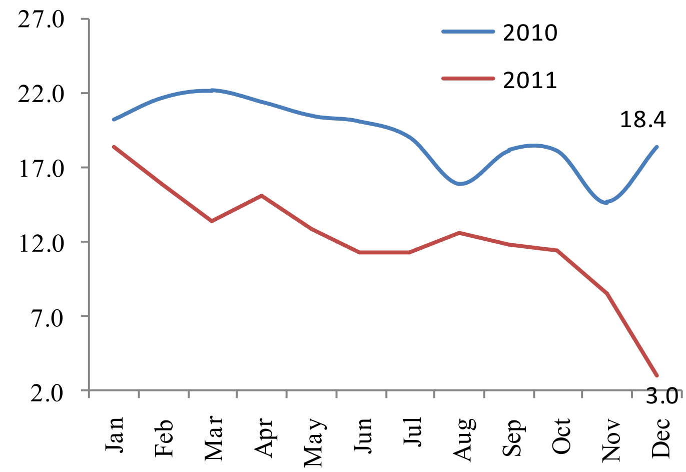
- **Something To Cheer:** Inflation has become a problem for the Indian economy, with elevated levels of inflation resulting in monetary tightening. Despite raising interest rates since January 2010, inflation has remained elevated and sticky. In December 2010, a sudden and unfortunate surge in prices of food and non-food articles led the RBI to push for more rate hikes. Monetary tightening was pursued despite slowing economic growth amid a weak global environment. Inflation is now showing signs of abating exactly a year after December 2010. Weak domestic and global economic environment and interest rate tightening has taken a toll on economic growth. Two quarters of sub-8% gross domestic product growth and a sharp decline in industrial output in November is certain to impact third quarter GDP growth too.

- **Reversal of Interest Rate Cycle:** RBI was compelled to pursue interest rates tightening as high inflation continued for the second year in a row. However, with growth concerns taking center-stage and inflation slowing, the central bank may decide to cut interest rates. RBI has hinted at addressing growth concerns as investments have been badly impacted due to the deteriorating economic climate. The central bank could embark on a rate reversal cycle in the monetary policy meet on January 24 if crude oil and exchange rate remain stable. RBI's measures at arresting rupee depreciation appears to be working and that too will help in containing inflation. Since August, the rupee has depreciated around 19% and that has an indirect bearing on inflation through costlier imports. RBI's reversal of interest rates cycle could improve business sentiments. However, it will take at least two quarters for growth to revive as impact of interest rates transmission works with a lag.

Weekly Food Inflation, % YoY

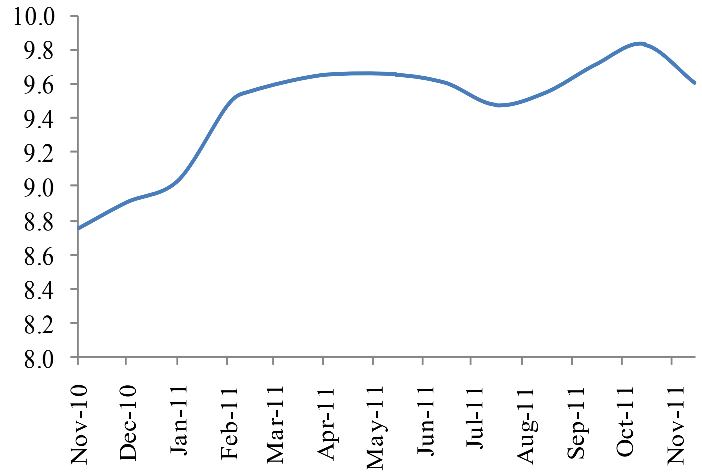


WPI Monthly Primary Articles Inflation, % YoY

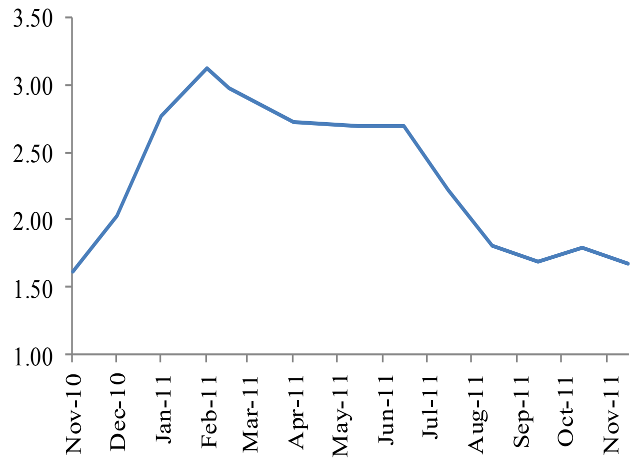


- **Three-Month Moving Average Trend:** RBI in its mid-quarter monetary policy had noted that decline in WPI inflation is visible from moving and seasonal adjustment trends. Moving averages inflation on a year-on-year basis and month-on-month basis both point to easing of price rise. Three-month moving average (3MMA) inflation on a year-on-year basis eased to 9.61% in November from 9.81% in October. Rise in WPI index on a month-on-month basis has also come down, which points to decrease in price pressures. Month-on-month rise in the index has eased from a high of 3% in the beginning of the financial year to around 1.6% since November. Easing price pressure could be due to slowing economy because of rate tightening.

3-Month Moving Average % YoY

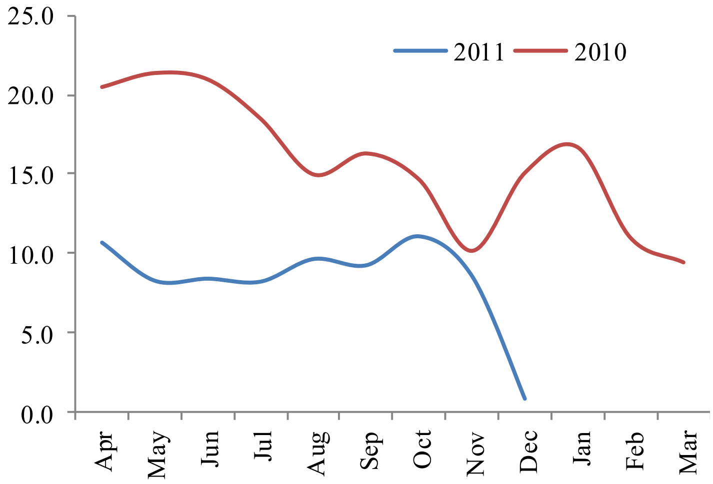


3MMA % MoM

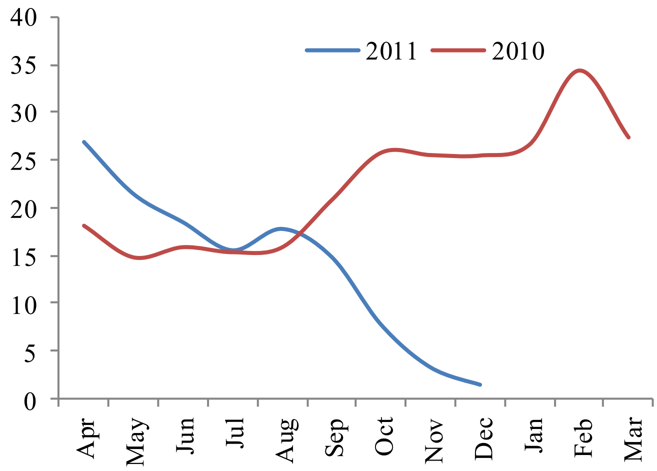


High Base Periods :

Food Inflation, % YoY



Non-Food Inflation, % YoY



Economic Weekly

Sector-wise Deployment Of Credit in November

Gross bank credit growth in November stood lower at 17.2% on a year-on-year basis compared with 22.3% in the same month a year ago. Gross bank credit data discussed here comprise credit of 47 scheduled commercial banks that represent 95% of total banking credit. Decline in bank credit growth is on expected lines due to monetary tightening and slowing economic growth. Non-food credit stood growth lower at 16.8% in November compared with 22.1% a year ago. Growth of credit to industry slowed to 20.9% in November from 27% a year ago, led by decline in loans taken by large industries. Growth of credit to services also stood lower at 16.9% in November compared with 22.5% in the previous year. Scheduled commercial banks' lending to priority sector also registered lower growth at 9.2% compared with 21% a year ago.

- **Non-Food Credit:** Non-food bank credit growth on a year-on-year basis stood at 16.8 % in November compared with 22.1% in the previous year. Non-food credit growth has declined due to slowing economic activity.

- **Credit To Agriculture:** Credit growth to the agriculture sector in November stood at 7.3% on a year-on-year basis, down from 20% in the previous year.

- **Industry Trends:** Credit growth to the industries segment stood 20.9% in November compared with 27% in the previous year. Credit growth to industries in November was led by higher growth in mining and quarrying, beverage and tobacco, basic metals and products, gems and jewellery and transport equipments. However, infrastructure, engineering, chemical and chemical products, food processing, wood and wood products and cement products, among others, witnessed decline in bank credit growth from last year.

- **Services Sector:** Credit growth to the services sector stood at 16.9% on a year-on-year basis in November compared with 22.5% in the previous year.

- **Banks' Exposure to NBFC High**: Credit growth to non-banking financial companies in November stood at 39.2 % on a year-on-year basis , up from 30.9 % in the previous year.

- **Real Estate Credit growth Lower**: Credit growth to the commercial real estate sector in November stood at 10.6% on a year-on-year basis compared with 19.1% in the previous year.

- **Personal Loans**: Personal loans stood higher at 13.4% on a year-on-year basis in November, up from 12.6% in previous year.

Deployment Of Bank Credit By Sectors

	Sector	Nov 19, 2010	Nov 18, 2011	Nov 19, 2010	Nov 18, 2011
		Rs Crore	**Rs Crore**	%	%
I	**Gross Bank Credit (II + III)**	3371551	**3950275**	22.3	**17.2**
II	**Food Credit**	56248	**77890**	38.4	**38.5**
III	**Non-food Credit (1 to 4)**	3315303	**3872386**	22.1	**16.8**
1	**Agriculture & Allied Activities**	411816	**441841**	20.0	**7.3**
2	**Industry (Micro & Small, Medium and Large)***	1465477	**1771183**	27.0	**20.9**
2.1	**Micro & Small**	215635	**244825**	16.3	13.5
2.2	**Medium**	153227	**197181**	26.1	28.7
2.3	**Large**	1096616	**1329177**	29.5	21.2
3	**Services**	802697	**938709**	22.5	**16.9**
4	**Personal Loans**	635313	**720653**	12.6	**13.4**
5	**Priority Sector**	1148808	**1253947**	21.0	**9.2**

* Break-up on next page

Industry-wise Bank Credit

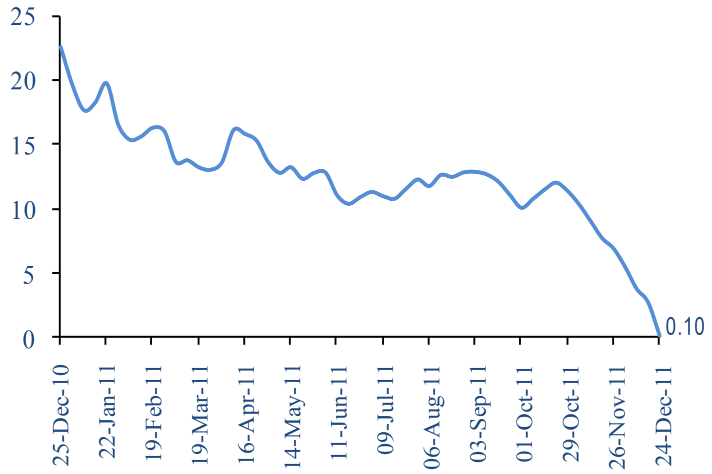
	Industry	Nov 19, 2010	Nov 18, 2011	Nov 19, 2010	Nov 18, 2011
				% YoY	% YoY
2.1	**Mining & Quarrying (incl. Coal)**	**19770**	**27910**	**27.0**	**41.2**
2.2	**Food Processing**	**69890**	**85725**	**30.3**	**22.7**
2.2.1	*Sugar*	18487	23596	14.2	27.6
2.2.2	*Edible Oils & Vanaspati*	12248	12572	48.8	2.6
2.2.3	*Tea*	2460	2327	17.3	-5.4
2.2.4	*Others*	36695	47230	35.3	28.7
2.3	**Beverage & Tobacco**	**10498**	**13692**	**-2.3**	**30.4**
2.4	**Textiles**	**127458**	**148121**	**18.1**	**16.2**
2.4.1	*Cotton Textiles*	63282	74824	16.2	18.2
2.4.2	*Jute Textiles*	1412	1380	5.5	-2.3
2.4.3	*Man-Made Textiles*	10988	10381	16.4	-5.5
2.4.4	*Other Textiles*	51776	61537	21.2	18.9
2.5	**Leather & Leather Products**	**6857**	**7590**	**16.0**	**10.7**
2.6	**Wood & Wood Products**	**5185**	**6113**	**27.9**	**17.9**
2.7	**Paper & Paper Products**	**20095**	**23868**	**16.3**	**18.8**
2.8	**Petroleum, Coal Products & Nuclear Fuels**	**58095**	**59110**	**-14.6**	**1.7**
2.9	**Chemicals & Chemical Products**	**91912**	**99483**	**19.9**	**8.2**
2.9.1	*Fertiliser*	11195	9658	-21.2	-13.7
2.9.2	*Drugs & Pharmaceuticals*	38840	44608	26.7	14.9
2.9.3	*Petro Chemicals*	14445	13895	59.1	-3.8
2.9.4	*Others*	27432	31322	20.9	14.2
2.10	**Rubber, Plastic & their Products**	**19074**	**24696**	**37.8**	**29.5**
2.11	**Glass & Glassware**	**4808**	**5610**	**3.3**	**16.7**
2.12	**Cement & Cement Products**	**29769**	**33983**	**40.9**	**14.2**
2.13	**Basic Metal & Metal Product**	**185209**	**237084**	**25.7**	**28.0**
2.13.1	*Iron & Steel*	145161	180234	25.7	24.2
2.13.2	*Other Metal & Metal Product*	40048	56849	25.8	42.0
2.14	**All Engineering**	**86364**	**102992**	**31.9**	**19.3**
2.14.1	*Electronics*	24576	28637	25.1	16.5
2.14.2	*Others*	61788	74355	34.8	20.3
2.15	**Vehicles, Vehicle Parts & Transport Equipment**	**41911**	**50824**	**16.5**	**21.3**
2.16	**Gems & Jewellery**	**35723**	**45869**	**17.2**	**28.4**
2.17	**Construction**	**43506**	**52440**	**16.4**	**20.5**
2.18	**Infrastructure**	**482189**	**579968**	**44.2**	**20.3**
2.18.1	*Power*	240343	306539	48.1	27.5
2.18.2	*Telecommunications*	97729	92031	91.3	-5.8
2.18.3	*Roads*	82359	106255	25.8	29.0
2.18.4	*Other Infrastructure*	61757	75143	11.3	21.7
2.19	**Other Industries**	**127164**	**166107**	**23.0**	**30.6**
2	**Total Industries**	**1465477**	**1771185**	**27.0**	**20.9**

Data are provisional and relate to select banks which cover 95 per cent of total non-food credit extended by all scheduled commercial banks. Industries marked in green indicate high growth rates

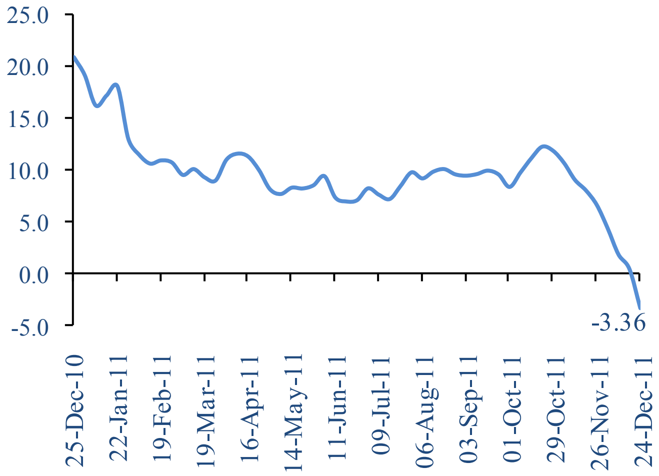
WPI Primary Articles Inflation Eases

Primary articles inflation in the week ended December 24 stood at 0.10% on a year-on-year basis compared with 2.70% in the previous week. Primary articles inflation eased because of fall in prices of food articles during the week. Food inflation turned negative for the first time in six-year to a negative 3.36% on a year-on-year basis, against 0.42% in the previous week.

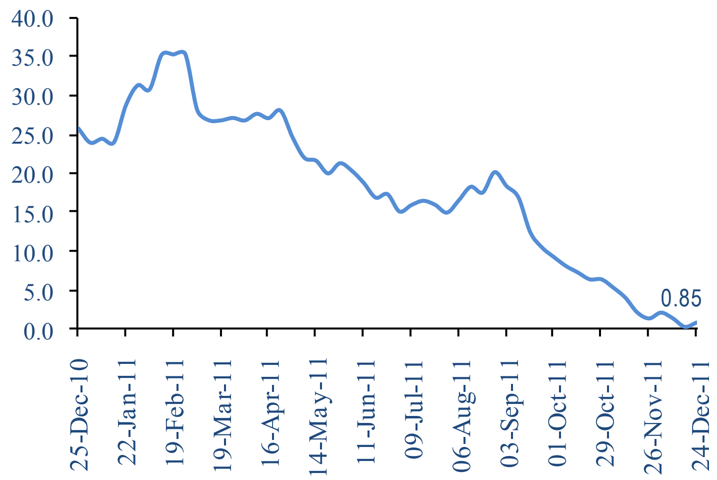
Primary Articles Inflation, % YoY



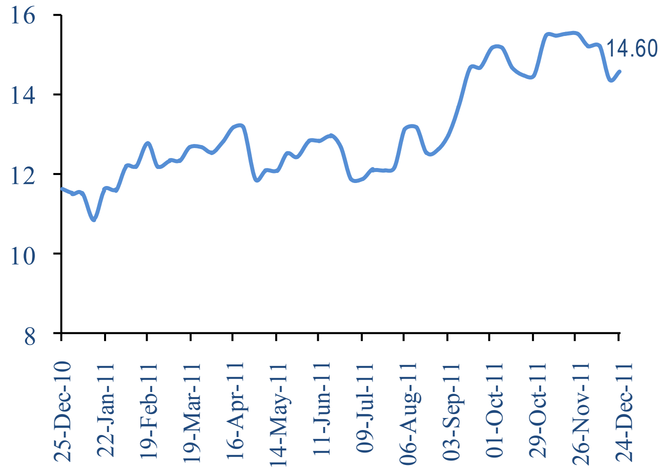
Food Inflation, % YoY



Non-Food Inflation, % YoY



Fuel Inflation, % YoY



Weekly Trends In Primary Articles Inflation

- Food inflation stood at a negative 3.36% on a year-on-year basis in the week ended December 24, against 0.42% in the previous week. Food inflation slowed during the week due to food prices easing 0.16% from the week before. Food prices fell due to lower prices of jowar, moong and fruits and vegetables, among others.
- Non-food articles inflation stood higher at 0.85% compared with 0.28% a week ago, due to rise in prices of non-food articles by 0.62% over the week. Non-food articles index rose due to higher prices of oilseeds.
- Minerals inflation stood unchanged at 23% on a year-on-year, as there was no change in the minerals index during the week.
- Fuel inflation stood higher at 14.60% on a year-on-year basis in the week ended December 24 compared with 14.34% in the previous week**.**

WPI Sub groups	Index	% YoY	% YoY	% WoW	% WoW
	24-Dec-11	24-Dec-11	17-Dec-11	24-Dec-11	17-Dec-11
Primary articles	197.6	0.10	2.70	0.16	-0.10
Food Articles	190.0	-3.36	0.42	-0.16	-0.37
Non Food Articles	178.7	0.85	0.28	0.62	0.11
Minerals	321.4	23.00	23.00	0.00	1.36
Fuel	172.7	14.60	14.37	0.00	0.17

Forex Reserves Fall Further

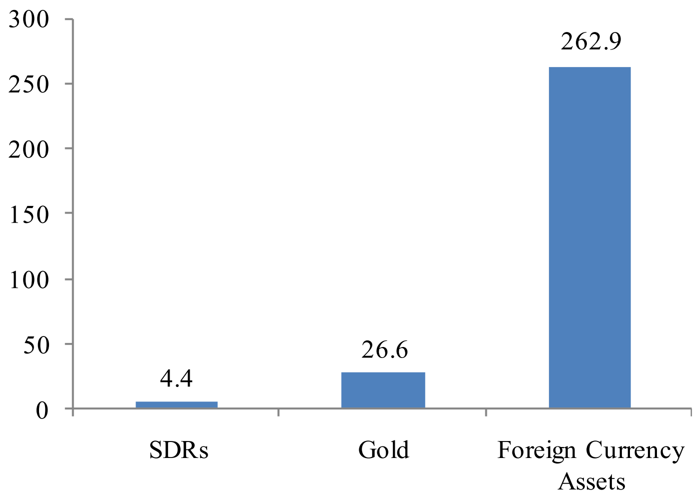
Foreign exchange reserves declined further by $4.5 billion to $296.3 billion in the week ended December 31, largely due to a fall in foreign currency assets and position in gold. Total foreign exchange reserves comprise foreign currency assets, special drawing rights and central bank's position in gold, all of which are measured in US dollars. Forex reserves declined by a total of $8 billion in December. Forex reserves have been on a declining trend for the past few months as imports have been buoyant while exports have come down sharply.

- In the week ended December 31, foreign currency assets declined $2.7 billion to $262.9 billion. Revaluation changes and RBI's intervention in forex markets could have led to decline in foreign currency assets.

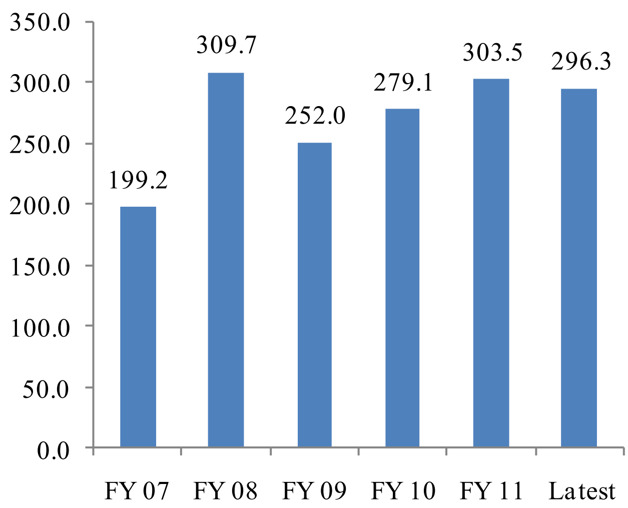
- Position in gold declined by $1.4 billion while special drawing rights and reserve position with International Monetary remained largely unchanged during the week.

$ billion	Forex Reserves	SDRs	Reserve Position In IMF	Gold	Foreign Currency Assets
10-Dec-11	306.8	4.5	2.6	28.0	271.7
17-Dec-11	302.1	4.4	2.7	28.0	267.0
24-Dec-11	300.9	4.4	2.7	28.0	265.7
31-Dec-11	296.3	4.4	2.7	26.6	262.9

Forex Reserves Components (in $ billion)



Forex Reserves Annual Trends (in $ billion)



Speech By RBI Executive Director

Financial Market Volatility and the Risk Management Imperative

RBI Executive Director V.K. Sharma recently delivered a speech in Bangalore on 'Financial Market Volatility and the Risk Management Imperative'.

- The speech was delivered in the backdrop of the past few years of financial volatility and slowdown in global economy. Financial risk management, according to Sharma, is not about eliminating risk but first determining threshold and risk tolerance and aligning it with the existing entity's risk. The RBI executive director elaborated on the East Asian crisis and sub-prime crisis and the damage they can have on the financial system.

Link to the Speech:

http://rbi.org.in/scripts/BS_SpeechesView.aspx?Id=649

China To Assist Growth

China is expected to support further growth of its economy. Chinese Premier Wen Jiabao last week asserted that they would fine -tune monetary policy to support growth conditions. China may bring down reserve requirement ratios — the money that banks need to park with the central bank, the Chinese equivalent of India's cash reserve ratio — further after the recent cut to infuse liquidity in the system. Inflation in China declined to 4.2% in November, which signals easing of price pressures. Inflation in December is expected to remain stable around 4%, which is expected to help China's central bank to further ease monetary policy.

- **Money Supply Improves:** China's monetary data suggest that monetary conditions could ease going forward as it prepares for global shocks. However, owing to a cut in RRR in December 2011, money supply growth improved in December compared with November. China's money supply growth stood at 13.6% in December. Global economic conditions are not supportive for export-oriented economy like China.

- **Reserve Ratio Cut:** China eased RRR 50 bps to 21% last month. With signs of an impending slowdown, China is expected to cut rates further to help growth. China needs to improve liquidity conditions to help economic growth. Many economists expect 150 basis points cut in RRR in the first half of 2012.

- **People's Bank Of China:** With easing inflation, China is in a position to support growth. Chinese premiere's remarks that China will focus on growth indicate that steps to support growth are likely. People's Bank of China Governor Zhou Xiaochuan said last week in a statement that the nation must be ready to combat possible shocks from Europe's debt crisis and an uncertain U.S. economic outlook. China's central bank also remarked last week that they will continue to maintain prudent monetary policy in 2012 while controlling inflationary expectations. However, with decline in inflation, China might continue to ease policy rates as its economy is more prone to global slowdown.

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