

January 16, 2012

Economic Weekly



Indian Economy

***Industrial Growth Rebounds:** Industrial growth recovered to 5.9% in November on a year-on-year basis led by better-than-expected manufacturing growth. Index of Industrial Production growth was expected to turn positive in November due to a lower base. In the previous month, industrial output had shrunk because of a very high base. IIP growth of 5.9% in November, however, has thrown a surprise with sharp double-digit rebound in consumer durables' growth. Also, capital goods index came off a low of 25% contraction in October on a year-on-year basis to 4.1% contraction in November. Growth of basic goods stood at 6.3% in November from 4% in the previous month, largely due to improvement in the core sector. IIP growth in November has lifted hopes, but it is yet early to establish a reversal trend.

***WPI Inflation in December:** Wholesale Price Index inflation in December slowed to 7.47% from 9.11% in November. December WPI inflation is lowest in 24 months due to sharp decline in food inflation rate to 0.7% from 8.5% in November and because of high base.

***RBI's Intervention In Forex Markets:** Reserve Bank of India's intervention in forex market has increased after rupee depreciated to an all-time low in December. The central bank has intervened in forex market very actively, as can be seen in depleting forex reserves and RBI's sales/purchase data. In November, RBI sold \$2.9 billion to arrest further slide of the Indian rupee.

***WPI Primary Articles Inflation:** Primary articles inflation in the week ended December 31 stood at 0.51% on a year-on-year basis compared with 0.10% in previous week. Primary articles inflation stood higher because of rise in prices of food and non-food articles during the week.

***Money Supply And Credit Growth:** Money supply and credit growth both slowed further in the fortnight ended December 31. M3, or broad money, supply growth in the fortnight ended December 31 eased to 15.64% while credit growth slowed to 15.94%.

***Forex Reserves Fall Further:** Foreign exchange reserves declined further by \$2.8 billion to \$293.5 billion in the week ended January 7, largely due to a fall in foreign currency assets.

Global Economy

***S&P Downgrades 9 Euro Nations:** S&P downgraded ratings of nine euro nations, including France. On Friday, S&P cut AAA ratings of France and Austria by a notch to AA+ with negative outlooks. However, it reaffirmed AAA ratings on Germany, Belgium and the Netherlands. S&P downgraded Italy, Portugal, Spain, Cyprus by two notches while it lowered ratings of Malta, Slovakia and Slovenia by one level.

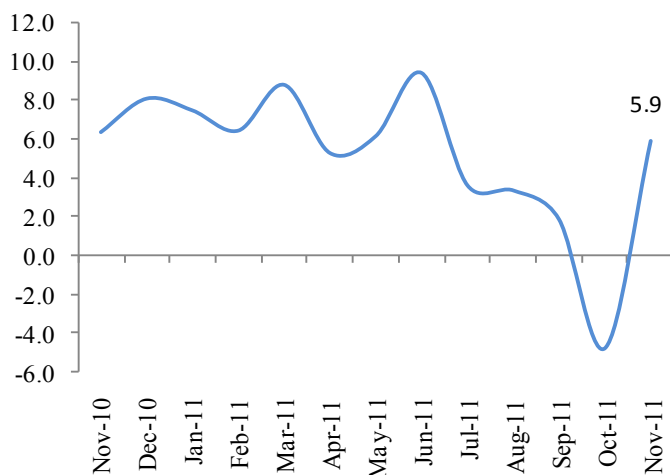
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Industrial Growth Turns Positive

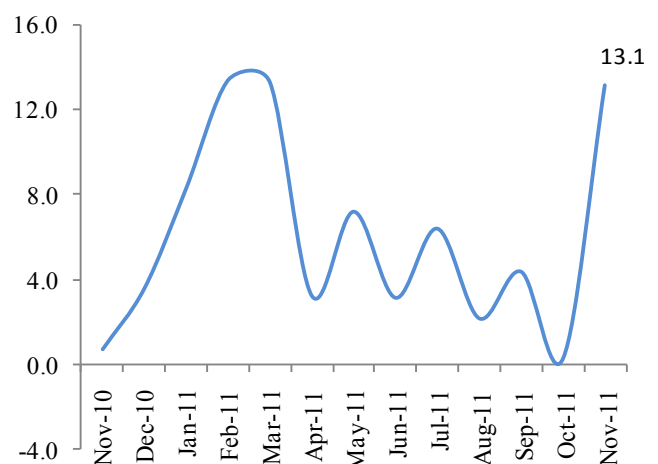
INDUSTRIAL growth recovered to 5.9% in November on a year-on-year basis led by better-than-expected manufacturing growth. Index of Industrial Production growth was expected to turn positive in November due to a low base in the previous year. In the previous month, industrial output had shrunk because of a very high base. IIP growth of 5.9% in November, however, has thrown a surprise with sharp double-digit rebound in consumer durables' growth. Also, capital goods index came off its lows of a 25% contraction in October, on a year-on-year basis, to 4.1% contraction in November. Growth of basic goods stood at 6.3% in November from 4% in the previous month, largely due to improvement in the core sector. IIP growth in November has lifted hopes, but it is still early to establish a reversal trend.

- ◆ **IIP By Use-Based Classification:** Industrial output grew 5.9% in November on a year-on-year basis and 5.5% on a month-on-month basis. According to use-based classification, expansion in industrial output was largely led by higher growth in basic and consumer goods. In sharp contrast, IIP had contracted 4.7% in October from a year ago due to month-on-month contraction of 3.3%. Recovery in IIP growth in November was in line with 6.3% revival in core sector on a year-on-year basis in November. Rebound in consumer non-durables could be due to restocking. However, that cannot explain the high double-digit growth of 14.8% in the sector. Consumer durables' growth in November was highest in last four years and might not be sustainable. Higher basic goods growth was led by improvement in electricity and coal sector.
- ◆ **Output By Industry Groups:** According to industry groups, industrial growth turned positive in November because of improved output in manufacturing and electricity sectors. Mining output in November shrank at a lower rate of 4.4% on a year-on-year basis compared with 6.1% in October. Manufacturing that accounts for 75.5% of the IIP index was largely responsible for the rise in overall industrial output. Manufacturing output grew 6.3% on a year-on-year basis as against contraction of 5.7% in the previous month. Electricity registered a sharply higher growth of 14.6% compared with 5.6% growth in the previous month.
- ◆ **Sector-wise Performance:** Industrial output improved across all sectors in November. Basic goods output expanded 6.3% in November from a year ago compared with 1.4% expansion in October. Capital goods output shrank 4.6% compared with 26.5% contraction in the previous month. Intermediate goods output turned positive with growth of 0.2% in October against contraction of 7.8% in October. Consumer durables output expanded 11.2% against contraction of 0.2% in the previous month. Consumer non-durables goods' output expanded 14.8% in October compared with 0.2% in the previous month.
- ◆ **PRU View:** November IIP growth came in higher than our estimate of 3.3%. Although we expect basic goods to provide momentum to industrial output growth, growth in consumer non-durables is likely to ease going forward. We expect IIP to be positive in December, but grow at a slower pace compared with November due to high base. It might be early to label the latest IIP numbers as part of a revival since growth is lower than last year. Also, intermediate and capital goods' growth haven't shown any turnaround — signs that are crucial to lift IIP numbers sustainably. We expect lower IIP growth in October-December (because of a contraction in October) to also keep gross domestic product growth at sub-7% levels, on a year-on-year basis.

IIP Growth, % YoY



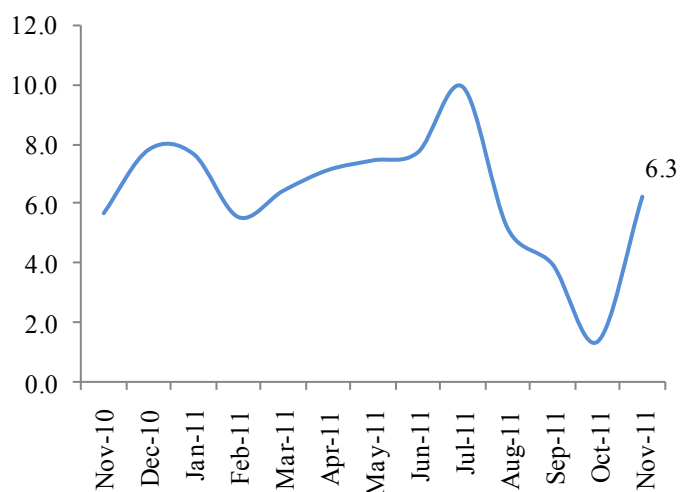
Consumer Goods, % YoY



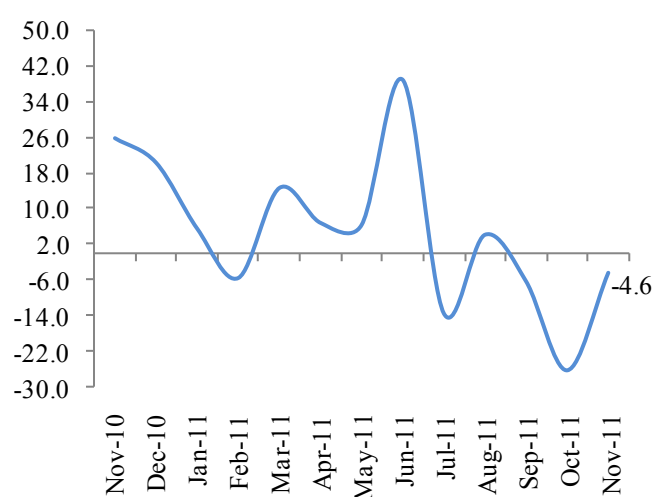
- IIP Trends:** IIP growth in November was 5.5% on a month-on-month basis. However, on a three-month moving average basis, the expansion was only 1% on year-on-year basis compared with 8% a year ago. Three-month moving average on a month-on-month basis expanded 1.2% in November, against contraction of 1.7% in October. The 3MMA gives an overall poor picture of IIP growth that is still to recover sustainably. The momentum has been lower as 3MMA growth in April stood at 7.1% on a year-on-year basis, which has now come down to 1% in November. Weak growth in investments has resulted in slower growth in capital goods sector this year and is hitting credit growth on the monetary front.

| % YoY | Weight % | Nov-10 | Apr-Nov 2010 | Jul-11 | Aug-11 | Sep-11 | Oct-11 | Nov-11 | Apr-Nov 2011 |
|-------------------------------|--------------|-------------|--------------|--------|--------|--------|--------|-------------|--------------|
| IIP | 100.0 | 6.4 | 8.4 | 3.7 | 3.4 | 2.0 | -4.7 | 5.9 | 3.8 |
| Mining & Quarrying | 14.2 | 6.9 | 7.0 | 0.7 | -5.5 | -7.1 | -6.1 | -4.4 | -2.5 |
| Manufacturing | 75.5 | 6.5 | 9.0 | 3.1 | 3.9 | 2.4 | -5.7 | 6.6 | 4.1 |
| Electricity | 10.3 | 4.6 | 4.5 | 13.1 | 9.5 | 9.0 | 5.6 | 14.7 | 9.5 |
| Basic goods | 45.7 | 5.7 | 5.5 | 10.0 | 5.8 | 4.0 | 1.4 | 6.3 | 6.2 |
| Capital goods | 8.8 | 25.7 | 18.2 | -13.7 | 4.0 | -6.5 | -26.5 | -4.6 | -1.0 |
| Intermediate goods | 15.7 | 4.3 | 8.1 | -0.1 | -1.0 | 1.3 | -7.8 | 0.2 | -0.3 |
| Consumer goods | 29.8 | 0.7 | 8.0 | 6.4 | 2.1 | 4.3 | 0.2 | 13.1 | 4.9 |
| Consumer Durables | 8.5 | 7.2 | 14.6 | 9.0 | 5.5 | 9.2 | -0.2 | 11.2 | 5.3 |
| Consumer Non Durables | 21.3 | -4.4 | 2.9 | 4.1 | -0.7 | -0.2 | 0.7 | 14.8 | 4.6 |

Basic Goods, % YoY

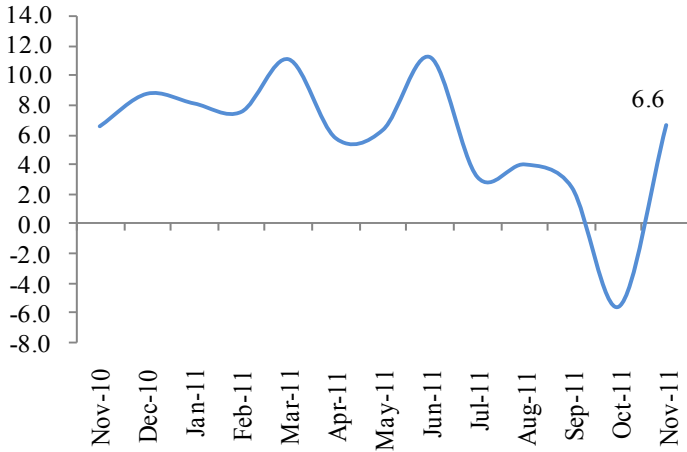


Capital Goods, % YoY

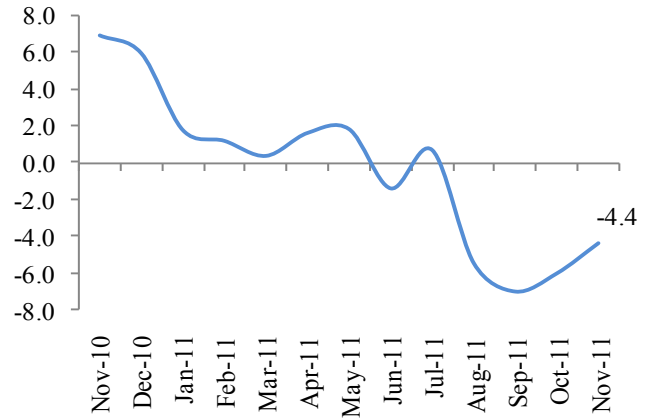


IIP Monthly Trends:

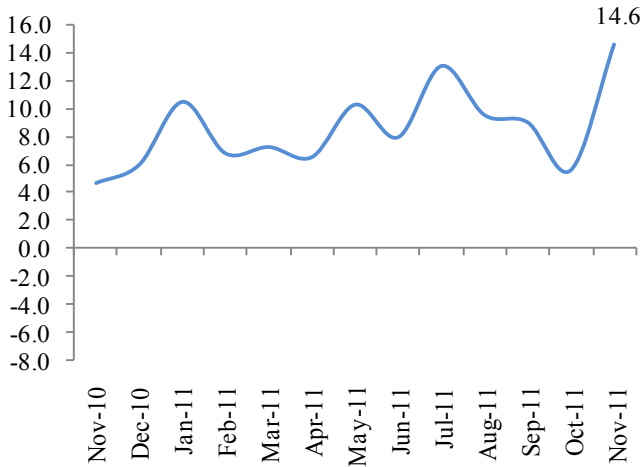
Manufacturing, % YoY



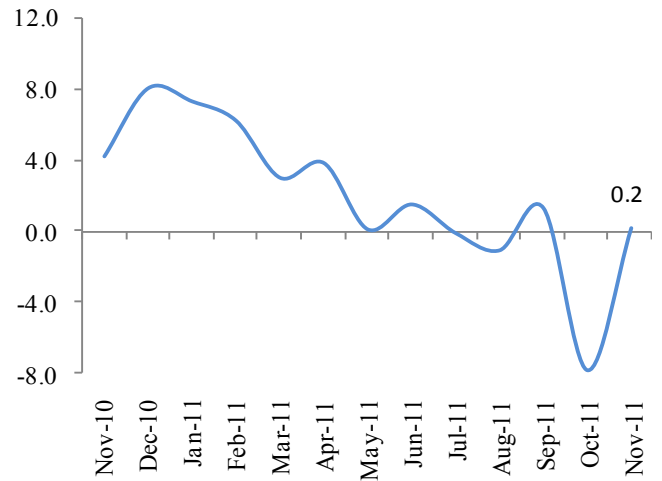
Mining, % YoY



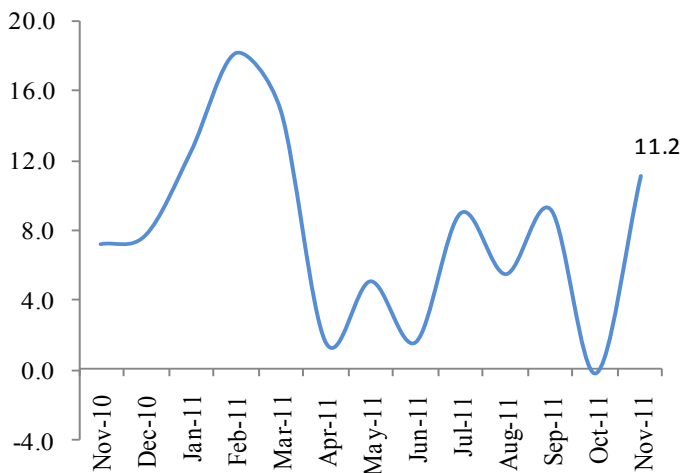
Electricity, % YoY



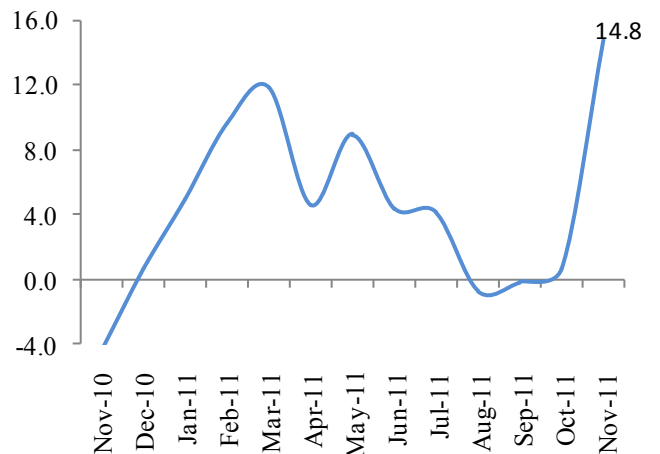
Intermediate Goods, % YoY



Consumer Durables, % YoY



Consumer NoN Durables, % YoY

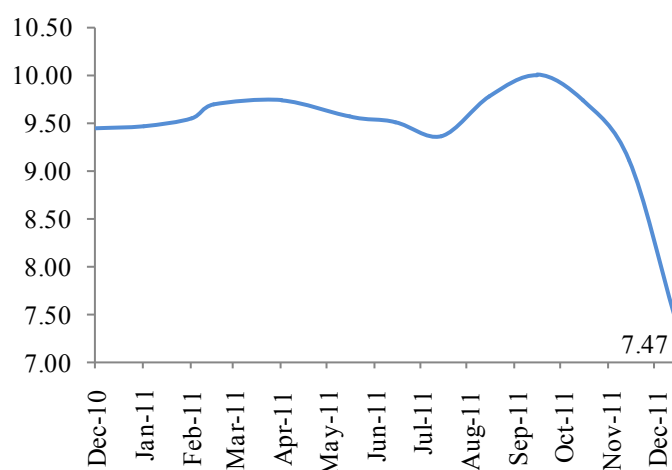


WPI Inflation At 2-Year Low At 7.47%

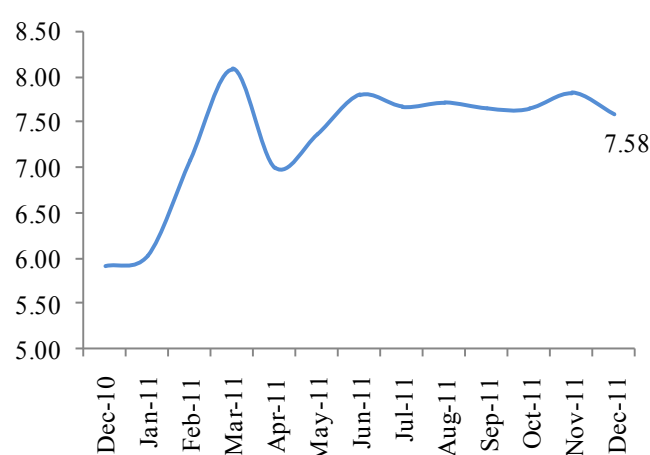
WHOLESALE Price Index inflation in December slowed to 7.47% from 9.11% in November. December WPI inflation is lowest in 24 months due to sharp decline in food inflation rate to 0.7% from 8.5% in November and because of high base. Core inflation — the indicator tracked by Reserve Bank of India — also eased to 7.58% compared with 7.82% in November. Manufactured inflation eased to 7.41% from 7.70% in November. Broad-based deceleration in inflation might help RBI weigh rate cut options.

- ◆ **Inflation Trends:** Primary articles inflation in December eased to 3.1% on a year-on-year basis from 8.5% in the previous month due to decline in index by 1.6% and high base effect. Food inflation slowed to 0.7% in December on a year-on-year basis from 8.5% in November. Non-food inflation eased to 1.5% in December from 3.2% in November due to base effect. Fuel inflation eased to 14.7% from 15.5% in the previous month. Manufactured products inflation in December stood at 7.47% from a year ago compared with 7.82% in November.
- ◆ **Core Inflation:** Core inflation slowed to 7.58% in December on a year-on-year basis compared with 7.82% in November. Lower demand could be the reason that restricted pass-through of higher prices to consumers. Demand destruction due to higher inflation and higher cost of credit could be reasons that non-food manufactured inflation is easing. Decline in core inflation is essential before RBI can cut rates.
- ◆ **Monetary Tightening:** RBI tightening interest rates 13 times in last 21 months has adversely impacted industrial growth. Inflationary expectations are easing on prospects of slowdown in growth, and this is essential to rein in inflation. RBI expects inflation to ease to 6.5% by April. We expect RBI's monetary policy to be based on its understanding of growth and core inflation.
- ◆ **Revisions:** WPI inflation for October was revised upwards to 9.87% from 9.73% provisional. The extent of upward revisions have come down in recent months, which indicates inflation is slowing.
- ◆ **April-December Inflation Trends:** Average WPI inflation in April-December stood at 9.38% on a year-on-year basis compared with 9.6% last year. In April-December, average primary articles inflation stood at 10.9% on a year-on-year basis, fuel 13.6% and manufactured inflation 7.6%. Primary articles and fuel have been key drivers of inflation so far. However, recent decline in primary articles inflation to a low of 3.1% raises hopes that overall inflation might decline further going ahead.

WPI Inflation, % YoY



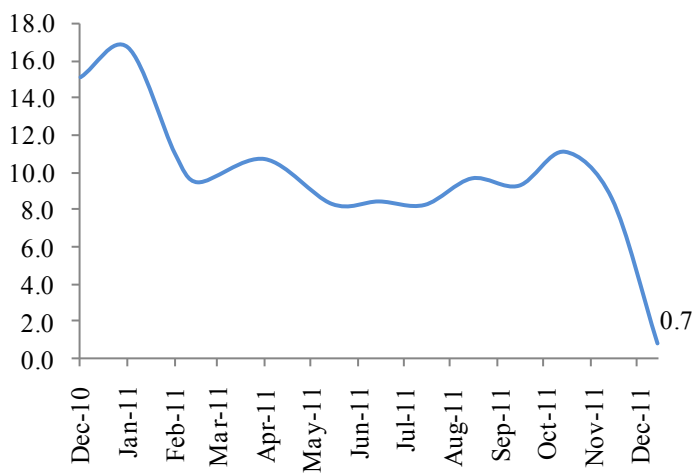
Core Inflation, % YoY



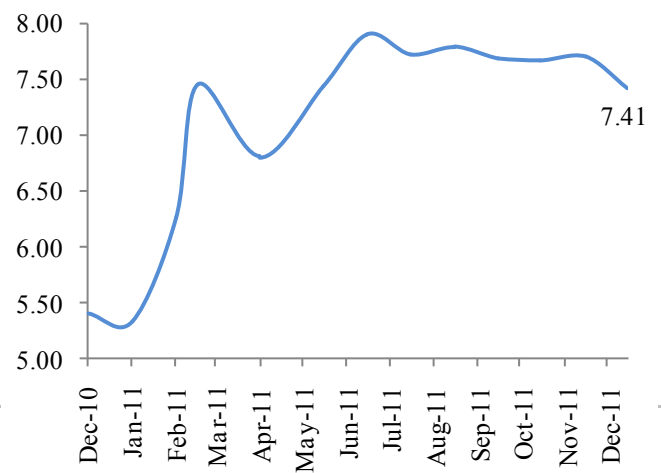
WPI Trends:

| | Dec-11 | % YoY | % YoY | % MoM | % MoM |
|------------------------------|--------|--------|--------|--------|--------|
| | Index | Nov-11 | Dec-11 | Nov-11 | Dec-11 |
| WPI | 156.9 | 9.11 | 7.47 | -0.06 | 0.00 |
| Primary articles | 197.9 | 8.5 | 3.1 | -1.57 | -1.59 |
| Food Articles | 190.8 | 8.5 | 0.7 | -1.99 | -3.10 |
| Non-Food Articles | 178.6 | 3.2 | 1.5 | -1.45 | 1.30 |
| Fuel | 172.6 | 15.5 | 14.9 | 0.94 | 0.58 |
| Manufactured products | 140.6 | 7.7 | 7.4 | 0.50 | 0.57 |

Food Inflation, % YoY



Manufactured Inflation, % YoY

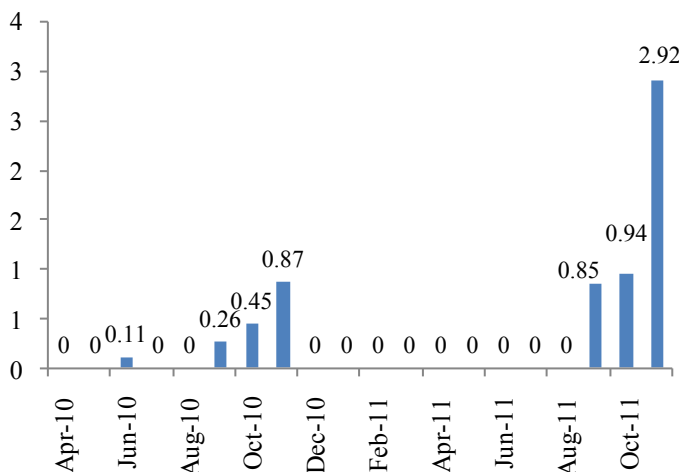


RBI's Intervention In Forex Market

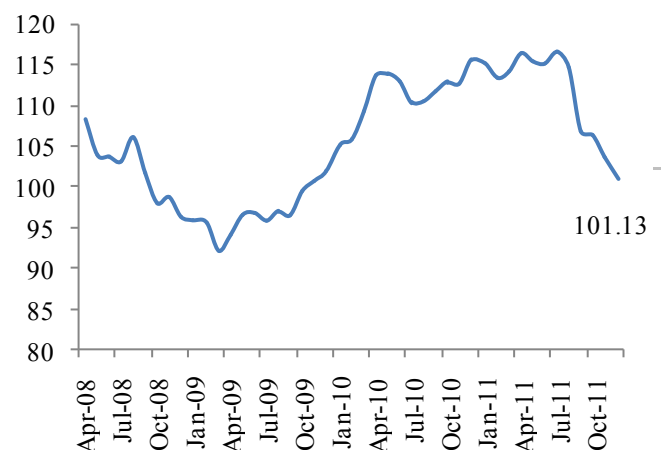
RESERVE Bank of India's intervention in the forex market has increased after rupee depreciated to an all-time low against the dollar in December. RBI has intervened in the forex market very actively, as can be seen in depleting forex reserves and RBI's sales/purchase data. In November, RBI sold \$2.9 billion to arrest further slide of the Indian rupee. Along with intervention in the market, the central bank took several steps to curb speculation on Indian rupee. This included lowering limits of banks and dealers in the forex market. Steps taken by the RBI seem to be working as the Indian currency's slide has been arrested and it appreciated from an all-time low of ₹54.30 against the dollar to the around ₹51.50 currently. Rupee's Real Effective Exchange Rate has declined to 101 in December from 114 in August. Rupee's depreciation exposes the inherent weakness in India's current account position. Higher imports makes India dependent on short-term capital flows to maintain balance of payments. Fall in foreign institutional investment flows to \$0.4 billion in April-November from \$31 billion a year ago also dented confidence in the Indian currency. Indian's precarious balance of payment position this year, coupled with speculation, seem to have taken a toll on the currency value.

- ◆ **RBI Takes Charge:** Sharp depreciation of the rupee to ₹54.30 on Dec 15 seems to have galvanised RBI into action — it announced several measures to contain downside volatility of the Indian currency. RBI reduced foreign currency exposure limits of exporters, importers, banks and dealers. As a result, rupee gained 5.1% from its all-time low. Forex reserves have fallen \$23.7 billion since first week of August, due to weak rupee and higher demand for dollars.
- ◆ **RBI's Intervention:** RBI's net sales and purchase data for November show that the central bank sold \$2.9 billion to contain the rupee's slide. Rupee witnessed sustained pressures owing to concerns on the Indian economy. This led rupee to weaken almost 23% to an all-time low of ₹54.30, since the first week of August. RBI sold \$850 million in September, \$940 million in October and \$2.9 billion in November. Thus, RBI has sold \$4.7 billion in three months to arrest the sharp downward volatility in rupee.
- ◆ **REER Slipped:** REER has slipped continuously since August as rupee came under sharp pressure against the greenback. Rupee not only lost against dollar but also against pound sterling, euro and the yen. REER, which reflects India's competitiveness against other nations, fell 11.9% against the basket of six major currencies. However, weak rupee is not going to benefit India's exports considerably, owing to slower global demand. Also, India's appetite for imports will rather be more detrimental to stability especially on the balance of payments side.
- ◆ **Inflation:** Higher import bill is impacting inflation indirectly. Indian rupee weakening around 17% to current levels since August has led to rise in import bill. Higher imports have resulted in sustained pressure in manufactured products' inflation despite weak demand. Government's efforts to contain inflation has led to building of fuel subsidies as higher fuel prices might stroke inflation again.

RBI's Net Dollar Sales, \$ billion



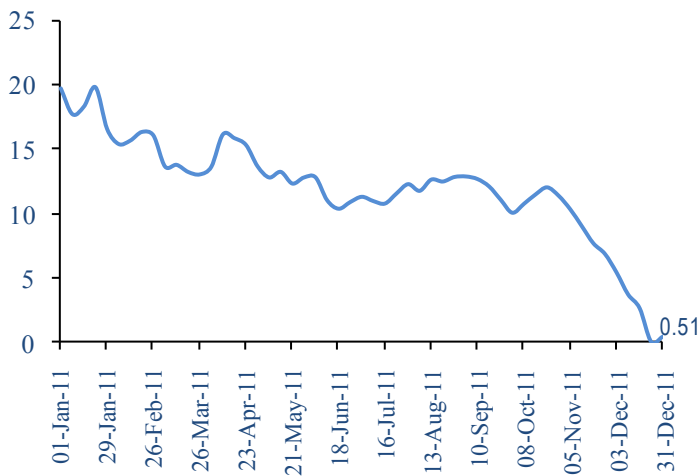
REER 6-currency Trade-based, 2009-10



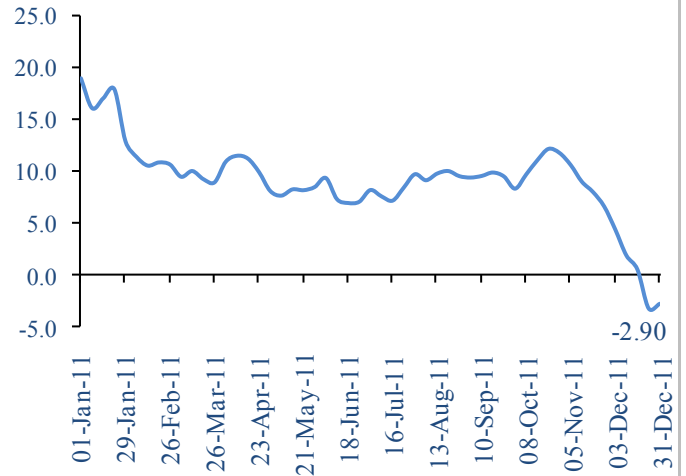
WPI Primary Articles Inflation

P R I M A R Y articles inflation during week ended December 31 stood at 0.51% on a year-on-year basis compared with 0.10% in the previous week. Primary articles inflation rose because of rise in prices of food and non-food articles during the week. Food inflation remained negative for the second consecutive week in six years at negative 2.90% on a year-on-year basis compared with negative 3.36% in the previous week.

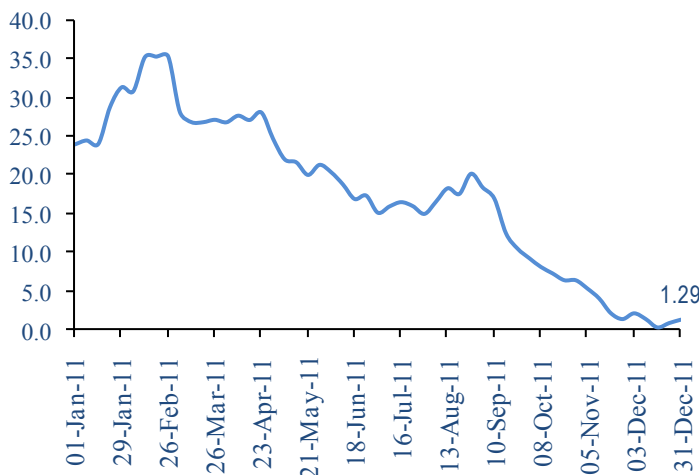
Primary Articles Inflation, % YoY



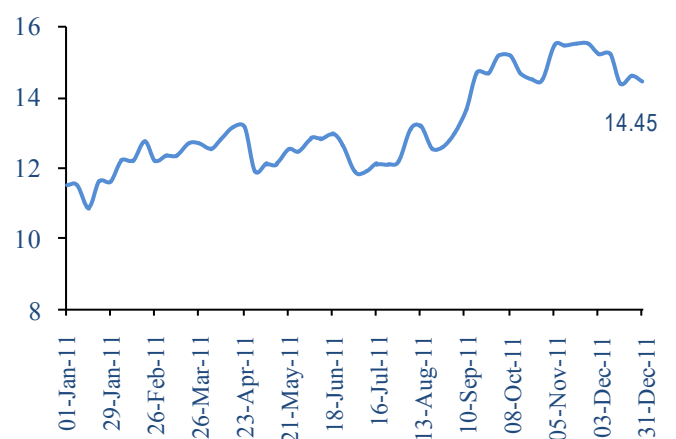
Food Inflation, % YoY



Non-Food Inflation, % YoY



Fuel Inflation, % YoY



Weekly Trends In Primary Articles Inflation

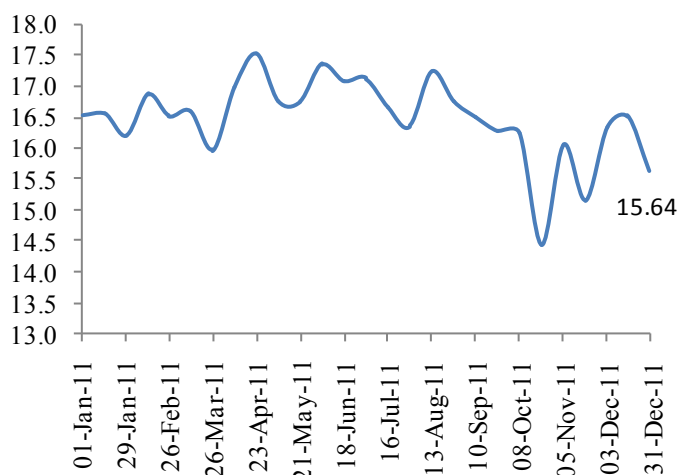
- ◆ Food inflation stood at a negative 2.90% on a year-on-year basis in the week ended December 31 compared with negative 3.36% in the previous week. Food inflation was off the previous week's low due to food prices rising 0.42% from the week before. Food prices rose due to higher prices of jowar, fish-marine, poultry chicken and milk, among others.
- ◆ Non-food articles inflation stood at 1.29% compared with 0.85% a week ago due to rise in prices of non-food articles by 1.29% over the week. Non-food articles index rose due to higher prices of oilseeds.
- ◆ Minerals inflation stood unchanged at 23.52% on a year-on-year as there was no change in minerals index during the week.
- ◆ Fuel inflation stood at 14.52% on a year-on-year basis during the week ended December 31 compared with 14.60% in the previous week.

| WPI Sub-groups | Index | % YoY | % YoY | % WoW | % WoW |
|--------------------------|--------------|--------------|-----------|-----------|-----------|
| | 31-Dec-11 | 31-Dec-11 | 24-Dec-11 | 31-Dec-11 | 24-Dec-11 |
| Primary articles | 198.6 | 0.51 | 0.10 | 0.51 | 0.16 |
| Food Articles | 190.8 | -2.90 | -3.36 | 0.42 | -0.16 |
| Non Food Articles | 181.0 | 1.29 | 0.85 | 1.29 | 0.62 |
| Minerals | 321.4 | 23.52 | 23.00 | 0.00 | 0.00 |
| Fuel | 172.7 | 14.45 | 14.60 | 0.00 | 0.00 |

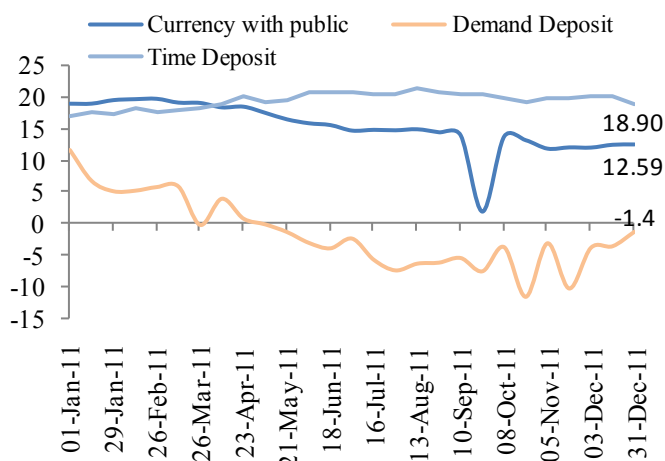
Money Supply And Credit Growth

- ◆ Money supply and credit growth both declined in the fortnight ended December 31. M3, or broad money, supply growth in the fortnight ended December 31 slowed to 15.64% from 16.52% a fortnight before. Credit growth in the same fortnight eased to 15.94% on a year-on-year basis from 17.08% in the previous fortnight.
- ◆ M3 growth in fortnight ended December 31 eased as growth in time deposits slowed sharply in the fortnight.
- ◆ Growth of currency with public in the fortnight ended December 31 increased to 12.59% on a year-on-year basis from 12.54% in the previous fortnight. Demand deposits shrank 1.40%, much less compared with contraction of 3.90% on year-on-year basis in the previous fortnight. Time deposit growth eased sharply to 18.90% on a year-on-year basis from 20.01%, largely due to high base in the same period last year.
- ◆ Credit growth in the fortnight ended December 31 stood at 15.94% on a year-on-year basis compared with 17.08% in the previous fortnight. Credit growth eased due to fall in non-food credit growth during the fortnight to 15.72% on a year-on-year basis from 16.81% in the previous fortnight while food credit declined 28.20% from 32.60% before.

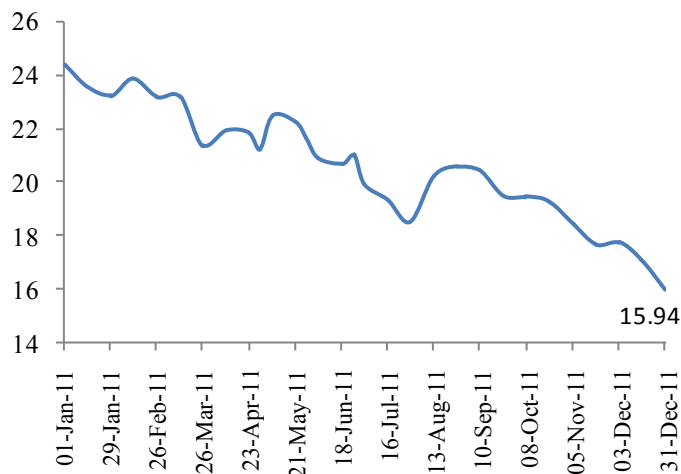
Money Supply, % YoY



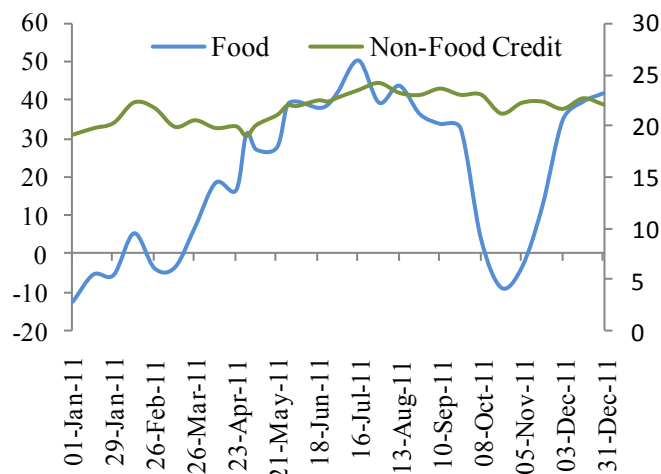
Currency And Time Deposits Growth, % YoY



Credit Growth, % YoY



Food And Non-Food Credit Growth, % YoY



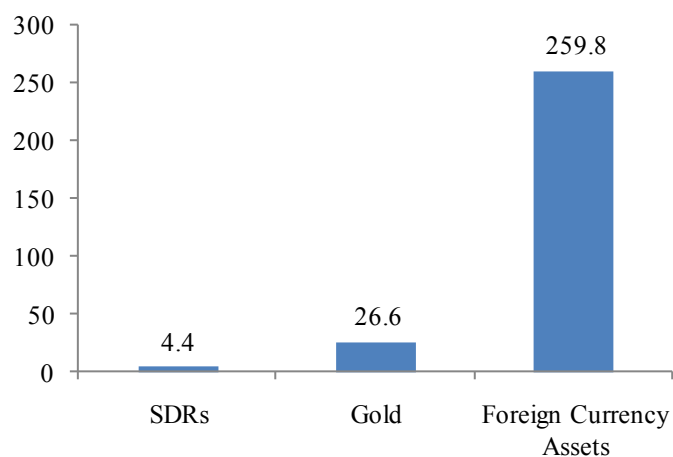
Forex Reserves Fall Further

FOREIGN exchange reserves declined further by \$2.8 billion to \$293.5 billion in the week ended January 7, largely due to a fall in foreign currency assets. 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 have been on a declining trend for the past few months as imports have been buoyant while exports have come down sharply.

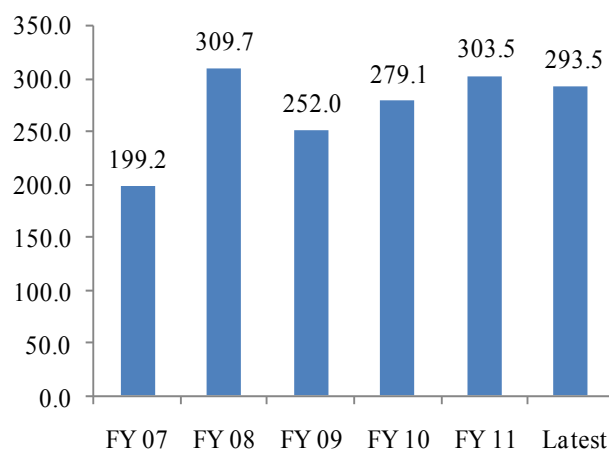
- ◆ In the week ended January 7, foreign currency assets declined \$3.1 billion to \$259.8 billion. Revaluation changes and RBI's intervention in forex markets could have led to decline in foreign currency assets.
- ◆ Reserve position with International Monetary Fund increased by \$0.3 billion while special drawing rights, position in gold remained largely unchanged during the week.

| \$ billion | Forex Reserves | SDRs | Reserve Position In IMF | Gold | Foreign Currency Assets |
|------------|----------------|------|-------------------------|------|-------------------------|
| 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 | 2.4 | 26.6 | 262.9 |
| 07-Jan-12 | 293.5 | 4.4 | 2.7 | 26.6 | 259.8 |

Forex Reserves Components (in \$ billion)



Forex Reserves Annual Trends (in \$ billion)



S&P Downgrades 9 Euro Nations

STANDARD & Poor's, one of the world's leading ratings agencies, downgraded nine euro nations including France. On Friday, S&P cut AAA ratings of France and Austria by a notch to AA+ with negative outlooks. However, it reaffirmed AAA ratings on Germany, Belgium and the Netherlands. S&P downgraded Italy, Portugal, Spain, Cyprus by two notches while it cut ratings of Malta, Slovakia and Slovenia by one level.

- ◆ **France Loses AAA:** France, a key euro nation, lost its coveted AAA rating on Friday. S&P said France faces risk of further downgrade if its public debt and budget deficit deteriorates. S&P's press release said "policy initiatives taken by EU (European Union) policymakers are insufficient to fully address ongoing systemic stresses in the eurozone". The December 9 political agreement does not supply sufficient additional resources or operational flexibility to bolster EU rescue operations. A reform process based on a pillar of fiscal austerity alone is self-defeating as domestic demand will fall". S&P said eurozone is headed for recession with 40% chance of its GDP contracting 1.5%.
 - ◆ **S&P's Downgrade:** Euro touched a 11-year low following the latest ratings downgrades by S&P. Euro nosedived against the dollar as key European nations such as France and Austria lost their AAA sheen. The downgrades expose debt defaults risks of nations such as Greece and Italy. The downgrades may lead to more speculation on euro that is already under severe pressure.
 - ◆ **Euro Financial Stability Fund Problem:** Downgrade of major nations such as France could impact rating of euro financial stability fund as these nations are its guarantors. Euro region's bailout fund could see problems in raising money with downgrade of its top support nations. EFSF is expected to raise finances to avoid default by Greece, Italy and Ireland.
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