Rural India: Where is It?

Highlights

- Varying Definitions Have led To Confusion In Defining The Segment
- This Hinders Better Prospecting Of The Sector
The Search For The Real Rural India

As urban markets saturate and companies spread their wings in search of new markets, everybody has the same question on their lips: what constitutes a ‘rural’ market? The quest to discover the real rural India still continues in great earnest. Almost every economic agency today has a definition of rural India. Here are a few definitions.

According to the Planning Commission, a town with a maximum population of 15,000 is considered rural in nature.

The National Sample Survey Organisation (NSSO) defines ‘rural’ as follows:
- An area with a population density of up to 400 per square kilometer,
- Villages with clear surveyed boundaries but no municipal board,
- A minimum of 75% of male working population involved in agriculture and allied activities.

The Census of India 2001 defines urban India but rural India is left for guesswork. Urban India is defined as:
- All statutory places with municipality, corporation, cantonment board or notified town area committee
- A place which satisfies the three criteria
  - Minimum population of 5,000
  - Density of population of at least 400 per sq. km. (1,000 per sq. mile)
  - At least 75% of male working population engaged in non-agricultural activities

RBI defines rural areas as those areas with a population of less than 49,000 (tier-3 to tier-6 cities).

Various public and private institutions have different definitions of rural India – most are lopsided and ignore one or the other important criteria.

Private companies, such as FMCG majors, have their own way of defining rural markets. All this leads to one clear conclusion that they all follow approaches convenient to themselves.

In such a scenario, estimations made by such studies about the size of the market or the potential purchasing capacity seems highly questionable and incomparable.

It is generally said that the rural areas house up to 70% of India’s population. Rural India contributes a big chunk to India’s GDP by way of agriculture, self employment, services, construction etc. As per a strict measure used by the National Sample Survey in its 63rd round, called monthly per capita expenditure, rural expenditure accounts for 55% of total national monthly expenditure. The rural population currently accounts for one-third of the total Indian FMCG sales.

Smaller packs of products at lower price points have done the trick for FMCG companies. Sales of premium skin-care products specifically related to urban areas are growing at double the pace in rural areas.

Contribution of the rural population is more to total FMCG sales in states that have higher rural population. An report from New Delhi-based think tank National Council of Applied Economic Research says that the urban consumer durables market is growing at 10% per annum while the rural durable market is growing at an impressive 25% per annum. Up to 40% of India’s auto sales comes from rural and semi-urban areas. Total size of rural mobile subscribers is approximately 201 million (TRAI, Q1, FY10) – higher than Brazil’s (173 million) and Indonesia’s (159 million) total mobile subscriber base. Two out of the five new mobile connections taken are in rural areas.

The major causes for all this are rising income, improving education and awareness levels, enhanced contact with the outside world, evolving consumption patterns, emerging lifestyles and, most importantly, shift in occupation from agriculture to manufacturing, self
employment and construction. However what cannot be denied is that the Indian rural population is still backward and poor. It comprises largely of illiterates and subsistence farmers. Yet, this same section produces a good chunk of India’s GDP and savings. Hence, it is a force that can be collectively presumed to have some buying power.

Their collective strength is illustrated by the various successful co-operative enterprises they have formed such as Amul, Warana, Dhara. Also, the lower income class is shrinking fast with rising income levels. According to NCAER, two-third of rural income will come from non-farm sources by 2012.

Also, in the past few years the government has been increasing its budgetary allocation to rural development (See table 1). This has helped the rural population improve its income levels through better employment opportunities. While such a transfer of resources to the rural areas has undoubtedly improved incomes and purchasing powers, they have also raised concerns about creating dependency on such income streams and the deleterious impact of shocks in case the pipeline dries up.

- **PRU View**

  It is high time a separate agency is established to define this large part of India’s population, since it is visible although its potential is not accurately measurable. It will help various public and private companies in taking calculated risks while entering these markets. So far, most of them have been wary of entering this unchartered territory due to poor infrastructure and non-availability of reliable information. The government itself will benefit with such a move as it needs to reach out to this section.
Food: Indian Innovation

India Top Innovation Market For MNCs, Food Product Cos: In a nondescript, small building next to McDonald’s plant at Taloja in Maharashtra, a team of 3-4 people is busy perfecting eggless pancakes and muffins. It is one of Big Mac’s about a dozen innovation centres across the world and its only vegetarian one. *(The Economic Times, November 29, 2010)*

- **PRU Analysis**

  India now figures among the top three innovations markets for multinational food companies. It is not just the second fastest growing market for food companies, but also a favourite centre of innovation.

  It has happened mainly due to a booming domestic market, buoyant and expanding middle class and a rapidly growing economy that is pulling people out of poverty. All these causes have made India gain prominence in the priorities of multinational food companies which do not want to take any chances with Indian tastes and sensitivities.

  Another very important reason is availability of talent in technical as well as scientific food research. Besides, cost of innovation is much lower here compared to the developed world.

  Hence, a host of multinational food companies have either introduced or plan to introduce products suiting Indian taste. Most of them, such as McDonald’s, Domino’s, KFC, PepsiCo, Hindustan Unilever, GlaxoSmithKline and Nestle, have established innovation centres in India.

  McDonald’s almost redesigned its menu and created new products for the Indian market. It has its only vegetarian innovation centre in Maharashtra that churns out products to sustain customers’ excitement. Locally innovated products contribute a big chunk to its topline.

  Domino’s has a R&D centre in Noida, near Delhi. Its locally created cheese burst pizza and peppy paneer pizza contribute 65% to its revenues. Local innovations of PepsiCo, such as Kurkure and Aliva biscuits, generate 25% of its total volume growth per annum.

  Nestle is also establishing its ₹230-crore R&D centre in Haryana, mainly to create local products in cereals, beverages, culinary and dairy segments. Interestingly, some of these local innovations are making inroads into foreign territories too. McDonald’s started exporting McPuff, McAloo Tikki burger, McVeggie burger to west Asia five years ago.

  HUL’s key innovations this year include Brooke Bond Sehatmand, Knorr Soupy Noodles, Annapurna low sodium salt and vitamin -fortified tea. India is the only country where GSK’s food business has locally created products such as biscuits and Horlicks Foodles instant noodles.

Aviation: Clipping Their Wings

India To Act Over Predatory Airline Pricing: India has warned domestic airlines that it intends to crack down on ‘predatory pricing’ after carriers sharply increased fares on popular routes during a recent festival, as overall passenger traffic surges. *(Financial Times, November 25, 2010)*

Air Traffic Up 18.3% Till October: Led by budget carriers SpiceJet, Go Air and IndiGo, India’s domestic airlines registered an 18.3% growth, carrying 41.93 million passengers in the January-October period this year against 35.45 million passengers during the like period last year. *(The Economic Times, November 22, 2010)*

- **PRU Analysis**

  The peak travel and tourism season begins in October each year and lasts till next March. With the onset of the peak travel season, total domestic passengers carried by the scheduled airlines of India rose to 46.17 lakh in October 2010, compared to 39.11 lakh in September 2010.
The airline industry was hit badly by the 2008 global slowdown, which led to a fall in passenger traffic. Rising traffic is an indication of revival, particularly in India. Business-related travel was also down earlier due to a cautious cost approach adopted by several companies.

Given the surge in demand for air tickets this year, domestic airlines raised fares. Reports state that economy class tickets are being priced at ₹17,917 for one way travel on the Mumbai-Delhi route. Business class tickets on the same route have gone up to ₹35,000.

Looking at the ‘predatory pricing’ policy followed by the airlines, the Directorate General of Civil Aviation (DGCA) sent a notice to airlines last week, questioning the sudden increase in some fares.

DGCA may even determine a price band for domestic air fares. However, it is not known what will determine such a price band. Besides, considering that India is more or less a free economy, such a regulation may seem out of place.

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Auto: No Breakdown

**No Break For Carmakers In Dec:** Booming demand in November has forced carmakers to refrain from the tradition of year-end production breaks to prevent piling up of inventories. *(The Economic Times, November 29, 2010)*

- **PRU Analysis**

  This is certainly a year of records for the automobile industry -- the highest ever production by a number of companies. The industry is growing at an unprecedented rate despite challenges such as rising raw material costs, increasing competition and launch of record new models per month. The presence of old and new models has only presented a slew of choices and helped boost demand instead of killing the market for old models.

  Demand is so high, at 30%, backed by the festive season that it has led to long waiting periods for various models. Companies are churning out cars at the highest possible rate and yet are not able to meet demand. Hence, most of them have decided to not take their yearly breaks in December, when they usually shut down their plants for maintenance.

  In December, usually there is lower offtake by dealers and companies shut down their factories for 8-10 days for maintenance. But this year demand has been higher than supply for most part of the year, forcing manufacturers to defer a shutdown. According to the Society of Automobile Manufacturers (SIAM), demand for cars may double to three million by 2015. Some plans of carmakers to meet the burgeoning demand are mentioned below:

  ◆ To cut the long waiting periods for Innova and Fortuner, Toyota Kirloskar combined its festive season break with a plant shutdown by taking a six day shutdown in November itself, so as to minimise the impact of supposed annual shutdown in December on production.

  ◆ General Motors used to shut down its plants twice a year for maintenance. But now, to avoid compromising on production, it has changed the plan. It reduced the number of maintenance days to five from 8-10 earlier and will conduct only annual maintenance.

  ◆ Renault has cut down its maintenance period from two weeks to one week in December.
December 1, 2010

Mercedes is also cutting short its Christmas break at its global plants owing to rising demand for new models.

Recent Milestones: General Motors crossed the 1-lakh-unit sales mark on November 27 for the first time in India since its inception, thanks to the strong sales of Chevrolet Beat and Cruze.

Hyundai reached the 20-lakh-units mark on November 30, 2010, in record time of 12 years.

Capital Goods: Result Analysis (Q2 FY11)

Healthy Topline Growth

The companies under our coverage (7) witnessed an overall improvement in execution, pick-up in order book and higher volume growth for Q2 FY11. Players such L&T, BHEL, Siemens and Cummins surprised with their performance. Crompton Greaves, which derives a substantial portion of its business from global markets, reported subdued growth in rupee terms mainly due to the rupee’s appreciation against the euro.

Stellar performers, such as BHEL and Cummins, witnessed over 25% YoY growth, which led to an overall net sales growth of 19.4% in the capital goods space. The exception was ABB India, which saw disappointment this quarter as well. Net sales contracted 8% YoY, led by a drop in power products and process automation segments. Both segments fell, 16% and 9% respectively, YoY.

During Q1 FY11, companies’ topline growth was weak due to slower execution of projects. However, they picked up this quarter on the execution front.

<table>
<thead>
<tr>
<th>Companies</th>
<th>Net sales</th>
<th>Raw material</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Q2FY10</td>
<td>Q2FY11</td>
</tr>
<tr>
<td>BHEL</td>
<td>6,625</td>
<td>8,328</td>
</tr>
<tr>
<td>L&amp;T</td>
<td>7,919</td>
<td>9,331</td>
</tr>
<tr>
<td>CG</td>
<td>2,189</td>
<td>2,398</td>
</tr>
<tr>
<td>Siemens India Ltd</td>
<td>2,498</td>
<td>3,025</td>
</tr>
<tr>
<td>Cummins</td>
<td>619</td>
<td>1,091</td>
</tr>
<tr>
<td>BEML</td>
<td>483</td>
<td>509</td>
</tr>
<tr>
<td>ABB*</td>
<td>1,454</td>
<td>1,334</td>
</tr>
<tr>
<td>Total</td>
<td>21,787</td>
<td>26,016</td>
</tr>
</tbody>
</table>

^ Siemens India (Q4 FY10) PLEASE MENTION EXPLICITLY THE CO’S REPORTING YEAR
*ABB, India (Q3 CY2010) DITTO

Stable Operating Performance

Aggregate operating profits dropped 7.19% YoY. Most companies under our coverage reported stable operating margins in spite of rise in raw material prices. However, in subsequent quarters, there could be rising pressure from metal prices. Among these companies, Cummins India recorded the highest growth of 91.5% in operating profit, even though raw material cost increased 76.7% YoY. Revenue growth was driven by growth in exports and domestic orders. ABB India’s operating profits fell drastically by 98% YoY. Raw material cost as percentage of total income increased to 79% for the quarter.

Order Books: An All Time High

Most witnessed a growth momentum in order book positions during the quarter, led by robust demand in the power sector and pick-up
in the industrial capex cycle. We expect the momentum to continue in the foreseeable future. The aggregate order book grew 28% YoY in this quarter.

**PAT & Outlook**

BHEL, Cummins and Siemens India recorded a bottomline growth rate of over 30% YoY. In case of BHEL it still continues to be strong, especially in the boiler turbine generator (BTG) segment, which forms a key part of the power plant (See table 4).

Concerns of competition from Chinese companies in the power equipment segment will continue as a proposal for withdrawal of import incentives has been rejected in spite of massive lobbying by the company.

As for Cummins India, PAT grew by a robust 90% YoY. The company perceives strong demand in the power generator sets and construction machinery business. It has dominance in manufacturing of 200-KVA generator sets and is currently in the middle of commissioning a 20,000-KVA generator facility at Phaltan, Maharashtra. This will contribute to revenue generation from FY12.

Siemens India’s revenue growth was mainly driven by the industrial recovery and improved execution in power transmission. It has healthy earning visibility due to a robust order book – at ₹13,600 crore – by end of Q2FY11.

ABB India, whose net profit dropped 85% YoY, faces major concerns in power transmission and distribution due to capacity addition delays. This is affecting its growth prospects. The company is marked by weak order inflows, sluggish sales and higher operating profits.

**Half Yearly Result Analysis**

**Topline Growth:** As far as half yearly results are concerned, only Cummins India witnessed an over 25% YoY growth, which led to aggregate growth of 16.5% YoY. BHEL grew at healthy 21.2%, compared to the previous corresponding period.

On an average, topline for all five companies improved in H1 FY11 compared to H1 FY10.

**PAT & Outlook:** BHEL, Cummins India and BEML recorded bottomline growth of over 30% for H1 FY11 over H1 FY10.
BHEL is the positive surprise in the capital goods space here. It registered a robust bottom line growth of 54% for H1 FY11 compared to H1 FY11.

The company’s PAT grew by a mere 8.09% in Q2. Three of its major clients -- all three metros, namely Bangalore, Delhi and Chennai -- are making losses, affecting BEML’s topline. Operating margins are hit by rise in raw material costs, in excess of sales growth.

ICT: A Chip Above

Indian ICT Spending To Rise 10% In 2011, Says Gartner: India information and communication technology (ICT) spend is forecast to reach $71.9 billion in 2011, a 10.3% increase from 2010’s spending of $65.23 billion, according to Gartner. (The Economic Times, November 24, 2010)

Table 6: Long Term Vision

<table>
<thead>
<tr>
<th>Companies</th>
<th>Operating profit H1 FY10</th>
<th>H1 FY11</th>
<th>YoY %</th>
<th>PBT H1 FY10</th>
<th>H1 FY11</th>
<th>YoY %</th>
<th>PAT H1 FY10</th>
<th>H1 FY11</th>
<th>YoY %</th>
</tr>
</thead>
<tbody>
<tr>
<td>BHEL</td>
<td>2,383</td>
<td>3,019</td>
<td>26.69</td>
<td>2,048</td>
<td>2,653</td>
<td>29.54</td>
<td>1,328</td>
<td>1,809</td>
<td>36.22</td>
</tr>
<tr>
<td>L&amp;T</td>
<td>1,664</td>
<td>2,013</td>
<td>20.97</td>
<td>2,722</td>
<td>2,122</td>
<td>(22.04)</td>
<td>2,179</td>
<td>1,431</td>
<td>(34.33)</td>
</tr>
<tr>
<td>Cummins</td>
<td>246</td>
<td>426</td>
<td>73.17</td>
<td>244</td>
<td>426</td>
<td>74.59</td>
<td>177.0</td>
<td>308</td>
<td>74.01</td>
</tr>
<tr>
<td>BEML</td>
<td>53.70</td>
<td>62.00</td>
<td>15.46</td>
<td>28.7</td>
<td>35.0</td>
<td>21.95</td>
<td>18.9</td>
<td>29</td>
<td>53.97</td>
</tr>
<tr>
<td>Total</td>
<td>4,901</td>
<td>6,151</td>
<td>25.51</td>
<td>5,581</td>
<td>5,810</td>
<td>4.67</td>
<td>4,057</td>
<td>3,981</td>
<td>(1.87)</td>
</tr>
</tbody>
</table>

Table 7: IT End-User Spending Forecast, India, 2009-2014 ($ million)

<table>
<thead>
<tr>
<th>Hardware</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>CAGR 2009-14</th>
</tr>
</thead>
<tbody>
<tr>
<td>Software</td>
<td>2,112</td>
<td>2,421</td>
<td>2,768</td>
<td>3,124</td>
<td>3,521</td>
<td>3,960</td>
<td>13.4%</td>
</tr>
<tr>
<td>IT Services</td>
<td>6,223</td>
<td>7,591</td>
<td>8,774</td>
<td>10,181</td>
<td>11,815</td>
<td>13,691</td>
<td>17.1%</td>
</tr>
<tr>
<td>Telecommunications</td>
<td>42,100</td>
<td>47,664</td>
<td>51,097</td>
<td>54,487</td>
<td>58,178</td>
<td>61,668</td>
<td>7.9%</td>
</tr>
<tr>
<td>Total ICT</td>
<td>56,823</td>
<td>65,234</td>
<td>71,929</td>
<td>78,944</td>
<td>86,771</td>
<td>95,471</td>
<td>10.9%</td>
</tr>
</tbody>
</table>

Source: Gartner (November 2010)

• PRU Analysis

Details on the key segments of the industry are:

**Hardware:** Set to be the fastest growing segment with a compound annual growth rate (CAGR) of 20.4% over the next five years. Growth will be mainly driven by spending within the client computing space. Increasing rural prosperity, aided by growth in small office and small business segment, is the key growth driver in the PC segment, a media release says.

**IT Services:** In 2010, it is expected to post the strongest annual revenue growth of 22%.

Gartner expects the Indian IT services space to be driven by new projects in areas of business applications (CRM, ERP, BI), virtualisation and data center consolidation and green IT exploration. Also, the government and defence segments will create sizeable opportunities in large systems integration projects for application services.
Managed services around IT infrastructure will open up doors to application services.

**Telecom:** Forecast to account for 73% of the ICT market in 2010, it is witnessing a slowdown and is set to grow at 13.2%.

**PRU View**

The Indian software industry is mainly export-oriented. It saw lay-offs, pay-cuts and lower net employee additions during the global economic slowdown, particularly in major export destinations such as the US and UK.

However, with demand revival, utilisation rates of existing employees -- average revenue generated per head -- has risen drastically.

As per RBI data, software exports (net) grew 6.4% to ₹55,117 crore during the April-June 2010 quarter, compared to the year ago quarter. However, in dollar terms, it rose by a faster 13.8% over the year ago quarter.

Higher client additions and renewal in contracts by existing clients are expected to drive sales in 2010-11. Since exports account for over 60% of the industry’s total revenues, rupee’s strengthening vis-à-vis the dollar may erode revenues in rupee terms.

**Environment-CSR: A New Regime**

**Environmental Accounting, Reporting Set To Become Mandatory For Companies:** The government will make it mandatory for companies to report measures taken to prevent environmental damage as it steps up the drive to encourage cleaner production methods. The ministry of corporate affairs is revising the guidelines on corporate social responsibility (CSR) issued last year, to add detailed norms on environmental sustainability. The fresh norms relate to efforts to prevent wasteful use of natural resources and ensure scientific treatment of industrial waste. *(The Economic Times, November 18, 2010)*

**PRU Analysis**

Responsibility towards environment is becoming one of a crucial area of corporate social responsibility. Recent years have witnessed rising concerns over environmental degradation -- mainly through pollution of various types. For India, both environment protection and economic development are matters of great importance. However, some sort of trade-off is inevitable between the two.

To that extent, environmental accounting is required to measure the impact of corporate economic activities on the environment. A standard system in this regard is still evolving in India.

A study on the price of pollution in India by two World Bank officials shows the impact in terms of cost. They have calculated that damage to environment costs India about 9.5% of its GDP. But unless proper accounting is done either by the individual company or by the government, it will be impossible to determine if both have been fulfilling their responsibilities in this regard. Therefore, the need for environmental accounting has emerged.

The existing guidelines, while urging companies to be environmentally conscious, left it to them to take steps. Now, this new rule will come into force by the end of FY11. An accounting standard on environmental reporting is also being worked out by the Institute of Chartered Accountants of India to guide companies in the process. Though the norms are voluntary, they will require companies to report their performance in this regard in the form of disclosures in their annual reports. This will also help the government give a clear idea of the amount spent on conserving the global environment.
Steel: Game Change

Steelmakers Focus On Retail Expansion: Who would have thought steel could be sold from retail shops as small as your roadside kirana? Well, not only has the model succeeded, but steel makers want to sell 30-40% of their production through the retail route. Essar, JSW and Ispat Industries are among the major manufacturers who’re more than doubling their steel retail stores. (Business Standard, November 29, 2010)

• PRU Analysis

Per capita consumption of steel in rural India is a mere 2-2.5 kg, against the national average of 44 kg. So, there is more potential for growth in rural and semi urban areas as far as steel makers are concerned. In India, 70% of the population lives in rural areas. Hence, steel companies such as JSW, Essar and Ispat Industries are targeting these markets by opening their retail outlets.

Earlier steel was distributed by only one way -- mill to trader to customer. Many small and medium entrepreneurs operating in auto and consumer goods sectors are not well connected to their raw material. These exclusive retail outlets are beneficial for both the manufacturers and customers because:

♦ Companies are creating new customers out of the small and medium enterprises.

♦ It is like hedging. During slumps, projects of big customers in infrastructure and energy sectors slow down. A retail presence would help then.

♦ Earlier customers bargained over quality and price, while buying from traders. Now they can get purchase certified by the company.

♦ Earlier customers had to wait for at least three weeks for delivery. Now this period has been reduced vastly.

Essar Steel currently has 105 exclusive company-owned retail outlets in India, known as Hypermart. It also has 449 franchise outlets, known as Expressmarts. The company has a current capacity of 4.6 million tonnes and almost 33% of this is sold through retail. Essar is gearing up to tap the Saarc countries and the Gulf Cooperative Council region. Essar has opened Hypermart in Dubai, Sri Lanka and Indonesia too. It plans to hit 775 stores by 2012 from the current 554. The company is on its way to reach 10-million-tonne capacity next year and intends to sell one third through retail.

JSW Steel opened its first retail outlet – JSW Shoppe – in July 2008. Currently, it has 208 Shoppes and plans to reach 600 by 2012. Retail sales for 2009-10 was 0.64 million tones, with JSW Shoppe accounting for 16% of domestic sales. In 2010-11, the company believes Shoppes will contribute around 17% of total sales. Its objective is to reach sales and volumes of 25-30%. The company has a current production capacity of 7.8 million tonnes.

Similarly, Ispat Industries has a current capacity of three million tonnes and owns 110 outlets. Currently, retail sales account for 20% of its total sales. It’s focused on expanding its retail chain and plans to reach 200 outlets by the end of FY11 and 300 by 2012.

However, these outlets don’t provide credit. In future, they will have to find ways to meet customers’ credit needs. The companies also incur additional cost on setting up stores, which adds to its total expenditure.
Cotton: Fairweather Storm

Prices Rise Despite Rains: Cotton prices in the open market this season have so far remained satisfactory, giving a sigh of relief to the growers. The incessant rain and flood that had marooned the fields initially dashed hopes of farmers as they feared that the crop would get discoloured and the price would fall drastically. However, the first round of sales that began in the third week of November saw farmers fetching remunerative prices as traders and millers picked up the product from various auction centres. (Business Standard, November 30)

- PRU Analysis

India’s cotton season starts in October, and was delayed this year due to the monsoon. While Gujarat, one of the prominent cotton growing states, received heavy downpour this monsoon, the rains subsided and the adverse effect on output was expected to be only marginal.

The Cotton Advisory Board (CAB) had estimated production of 32.5 million bales for 2010-11, against 29.5 million last year. The increase was mainly attributed to higher acreage following the use of Bt seeds.

However, cotton arrival in the market so far portrays a different picture. According to the Cotton Corporation of India (CCI), by November 21, about 4.6 million bales of cotton had arrived from various states against 4.8 million bales during the same period in 2009-10. Gujarat tops the list with 1.4 million bales. In the last season, during the same period, arrivals from Gujarat stood at 1.8 million bales. The fall, despite increased acreage, is attributed to heavy rains.

Global cotton prices have been high due to a demand-supply imbalance. Domestic prices have followed the international trend. According to the Cotton Association of India, average prices of Shankar-6 kadi and J-34 scaled new high of ₹124 and ₹116 per kg on November 21.

Late arrivals in the market and high international prices may push prices even further in the near future. This would relieve cotton farmers, but has hit textile mills and exporters.

Exporters have run into trouble as ginners, who separate seeds from raw cotton fibre before converting it into consumable bales, are not able to procure cotton at such high prices. Hence, defaults are on the rise.

High cotton prices put pressure on textile makers’ margins. The Indian textile industry is labour-intensive. The government has to protect jobs in the sector. The only option right now is to suspend all exports till supplies improve.

Commodities: Rallying Point

In his mid-year review of the 2010-11 monetary policy, which was announced on November 2, Reserve Bank of India governor, D Subbarao, made a point about rising commodity prices globally and expressed a concern over how this could be contribute to stoking of inflationary fires in the Indian economy. PRU decided to check out some of the commodities and their global price trajectory over the past six months.

Prices of metals like Aluminium, copper and Zinc have risen by 10%, 18% and 7.33% respectively over their 6 month back prices in spite of the global slowdown (see table 8).

Aluminium

Improving demand prospects in emerging markets have driven the price rise in aluminium prices. The prices are however capped due to oversupply in the global aluminium market. We expect LME prices to trade in the range of $2,000-2,200 per tonne for the rest of FY11.

<table>
<thead>
<tr>
<th>Table 8: Metal Prices</th>
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<tbody>
<tr>
<td></td>
</tr>
<tr>
<td>Aluminium</td>
</tr>
<tr>
<td>Copper</td>
</tr>
<tr>
<td>Zinc</td>
</tr>
</tbody>
</table>
Copper

The copper price rally is mainly driven by supply side constraints and volume growth is expected to be muted as no new capacity is scheduled to come on stream.

However, the weakening of copper prices towards the end of November comes as a surprise since inventory on LME has been falling continuously. Inventory is down from the all time high of 5.5 lakh tonnes to the current 3.5 lakh tonnes as on November 29, 2010.

Zinc

Zinc prices shot up due to improving demand outlook from emerging markets. But the rally is not sustainable due to high inventories on LME, which, as on November 29, 2010, stood at 6.3 lakh tonnes.

Cotton

Cotton prices have scaled new highs this year. The global demand for raw cotton has been rising at a robust pace over the past few years. Global production, however, has not been able to keep pace.

There is a demand-supply mismatch globally. Floods in Pakistan (a major exporter) and export cap by the India (the second largest exporter) is going to further add on to the mismatch.

Recently cotton prices have also seen correction.

Sugar

The international prices have been soaring at least over the past eight months. The sharp run from $17.08/lb in the first week of April to a peak of $33.11/lb on November 9, 2010; to a little lower but comparatively quite higher (from April 2010) at $27.55/lb on November 30, 2010.

The rise has been mainly due to the tight global supply-demand situation. But now the prices are cooling and it is expected that they will further moderate from January 2011. It is due to expectations that the demand-supply situation will start easing from December 2010 as India will start exporting sugar due to good crop.

India has allowed sugar mills to complete their export obligation of 0.95 million tonnes between December 2010 and March 2011. Globally, the International Sugar Organisation has said there
will be a surplus of two million tonnes globally in the 2010-11 sugar season. The industry will finally see the demand-supply balance improving after two years of deficit.

**Crude Oil**

Crude oil prices in FY11 rose to $85 per barrel (average price of Brent variety) compared to $78 in March 2010. This were primarily influenced by a marginal pick-up in demand, upswing in equity markets of emerging economies, upward revision in oil demand forecast by International Energy Agency and a weak US dollar.

It must be noted that demand for oil during the winter months, known as ‘winter demand’, is higher than other seasons, particularly in the largest oil consuming nation, the US. Rising prices can also be a result of speculation that with central governments of various countries pumping in money, demand for oil will rise.
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