INDIAN ECONOMY

Mid Year Review

NOVEMBER 2009

Q S Consultants India Pvt. Ltd.

INTRODUCTION

Established in February 2008, Q S Consultants was conceptualized as a consultation firm providing advisory services in the Travel & Tourism, Infrastructure and Sustainable Business Practices Areas, bringing dedicated expertise and an imaginative approach to meet the demands of an industry in the midst of rapid transition and offer well-defined and executable strategies to achieve business objectives.

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Q S Consultants India Pvt. Ltd.

Outlook - Indian Economy

India's annual growth of GDP is projected at 6.7%[1] for 2009-10. This continues to reflect a significant deceleration from high growth of 9% during 2007-08 and the high average growth of 8.8% recorded during the five-year period 2003- 08 thus pointing to the continued persistence of the slowdown.

	Industry	Growth				
		2005-06	2006-07	2007-08	2008-09	2009-10
1	**Agriculture, forestry & fishing**	**5.8**	**4.0**	**4.9**	**1.6**	**2.6**
2	**Industry**	**10.2**	**11.0**	**8.1**	**3.9**	**4.9**
a	Mining & quarrying	4.9	8.8	3.3	3.6	-
b	Manufacturing	9.1	11.8	8.2	2.4	-
c	Electricity, gas & water supply	5.1	5.3	5.3	3.4	-
d	Construction	16.2	11.8	10.1	7.2	-
3	**Services**	**10.6**	**11.2**	**10.9**	**9.7**	**8.6**
a	Trade, hotels, transport & communication	12.1	12.8	12.4	9.0	-
b	Financing, insurance, real estate & business services	11.4	13.8	11.7	7.8	-
c	Community, social & personal services	7.1	5.7	6.8	13.1	-
4	**GDP at factor cost**	**9.5**	**9.7**	**9.0**	**6.7**	**6.7**

Table 1: Growth of GDP by Economic Activity (in percentage)

India's GDP growth during the first quarter of 2009-10 at 6.1% represents a modest recovery from the 5.8% growth registered during the preceding two quarters, though still lower than 7.8% growth that was achieved in the first quarter of 2008-09. The sequential recovery over the previous quarter was driven by notable turnaround in industrial output. During April to August 2009, both industry and core infrastructure sectors have shown accelerated growth and few lead indicators of services sector activities also suggest some pickup in growth momentum. The deficient monsoon coupled with recent floods in some States and their expected adverse impact on the kharif agricultural production, however, entail downside risk for the overall growth prospects.

	Industry	2007-08				2008-09				2009-10
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
1	**Agriculture, forestry & fishing**	**4.3**	**3.9**	**8.1**	**2.2**	**3.0**	**2.7**	**(0.8)**	**2.7**	**2.4**
2	**Industry**	**9.2**	**9.1**	**8.2**	**6.2**	**6.0**	**6.1**	**2.3**	**1.4**	**5.0**
a	Mining & quarrying	0.1	3.8	4.2	4.7	4.6	3.7	4.9	1.6	7.9
b	Manufacturing	10.0	8.2	8.6	6.3	5.5	5.1	0.9	(1.4)	3.4
c	Electricity, gas & water supply	6.9	5.9	3.8	4.6	2.7	3.8	3.5	3.6	6.2
d	Construction	11.0	13.4	9.7	6.9	8.4	9.6	4.2	6.8	7.1
3	**Services**	**10.8**	**10.3**	**10.3**	**11.8**	**10.2**	**9.8**	**10.2**	**8.6**	**7.8**
a	Trade, hotels, transport & communication	13.1	10.9	11.7	13.8	13.0	12.1	5.9	6.3	8.1
b	Financing, insurance, real estate & business services	12.6	12.4	11.9	10.3	6.9	6.4	8.3	9.5	8.1
c	Community, social & personal services	4.5	7.1	5.5	9.5	8.2	9.0	22.5	12.5	6.8
4	**GDP at factor cost**	**9.2**	**9.0**	**9.3**	**8.6**	**7.8**	**7.7**	**5.8**	**5.8**	**6.1**

Table 2: Quarterly Estimates of GDP by Economic Activity (in percentage)

- Overall growth in the Index of Industrial Production (IIP) was 10.4% during August 2009 as compared to 1.7% in August 2008 while core infrastructure-support sectors achieved growth rate of 7.1% compared to a growth of 2.1% for the same periods. This indicates a recovery in the industrial sector coupled with a notable acceleration in growth of core infrastructure. Manufacturing groups performed differently as follows:

1 *Q S Consultants economic forecasting model*

- **Negative growth areas:** Food products, jute and other vegetable fiber textiles (except cotton), metal products and parts and beverages, tobacco and related products.
- **Deceleration in growth:** Transport equipment and parts, chemicals and chemical products, paper and paper products and cotton textiles.
- **Acceleration in growth:** Wood and wood products (furniture and fixtures), non-metallic mineral products, textiles, rubber, plastic, petroleum and coal products, other manufacturing industries, metal and alloy industries, machinery and equipment and leather and fur products.

- During April-August 2009-10, the core infrastructure sector recorded higher growth at 4.8% compared to 3.3% during the corresponding period of the previous year led by acceleration in coal, cement, and electricity. The production of crude oil and petroleum refinery products, however, recorded a decline. The production of finished steel witnessed decelerated growth during the period.

- Lead indicators for services suggest pick up in activities relating to construction and telecommunications, even though external demand dependent services, such as tourism and cargo handled at ports, continue to be depressed.

- Information available on various lead indicators of economic activity in the second quarter of 2009-10 suggests that because of the deficient monsoon, kharif output may be adversely affected.

Aggregate Demand Drivers in India

Aggregate demand, which had moderated considerably in 2008-09, remained sluggish during the first quarter of 2009-10. Private consumption and investment demand continued to decelerate during the first quarter of 2009-10, with the former registering the lowest quarterly growth (1.6%) in recent years. Government consumption expenditure growth, which had risen sharply in the third and fourth quarters of 2008-09, moderated during the first quarter of 2009-10, but continued to remain in double-digits. During April- August, 2009 the key deficit indicators of the Central Government, viz., revenue deficit and fiscal deficit, were significantly higher than during the corresponding period of the previous year, reflecting the combined impact of slowdown induced decline in revenue receipts and increase in public expenditure consistent with expansionary fiscal stance. Corporate sector data indicate modest decline in sales growth during the first quarter of 2009-10, although profit margins improved.

			2008-09				2009-10
Item	2007-08	2008-09	Q1	Q2	Q3	Q4	Q1
Growth Rates							
Total Consumptionn Expenditure	8.3	5.4	3.8	2.1	9.0	6.1	2.8
(i) Private	8.5	2.9	4.5	2.1	2.3	2.7	1.6
(ii) Government	7.4	20.2	(0.2)	2.2	56.6	21.5	10.2
Investment	12.9	8.2	0.2	12.5	5.1	6.4	4.2
Change in Stocks	51.7	2.9	6.0	5.6	1.4	(0.9)	3.2
Exports	2.1	12.8	25.6	24.3	7.1	(0.8)	(10.9)
Less Imports	6.9	17.9	27.4	35.3	21.7	(5.7)	(21.2)
Relative Shares							
Total Consumption Expenditure	66.9	66.5	67.5	63.7	69.9	64.8	65.5
(i) Private	57.2	55.5	58.0	55.5	57.4	51.4	55.6
(ii) Government	9.8	11.1	9.6	8.3	12.5	13.4	9.9
Investment	31.6	32.2	32.2	34.5	30.9	31.6	31.6
Change in Stocks	3.1	3.0	3.2	3.2	2.9	2.9	3.1
Net Exports	(4.3)	(5.8)	(1.3)	(10.5)	(8.5)	(2.9)	1.6

External Economy

The adverse impact of the global crisis operating through the trade channel continued to depress India's trade transactions in 2009-10. In the first five months of 2009-10, merchandise exports and imports declined by 31% and 33% (year-on-year), respectively. In India's balance of payments for the first quarter of 2009-10, while exports declined, imports increased over the preceding quarter, reflecting the increase in oil prices. As a result, the balance of payments witnessed a higher trade deficit over the preceding quarter. Surplus in net invisibles, led by buoyant remittances, financed about 78% of the trade deficit. The current account, as a result, remained in deficit of US$ 5.8 billion. Return of capital inflows after the phase of net outflows experienced during the last two quarters of 2008-09, however, ensured the financing of the deficit without any loss of reserves. Including valuation gains and the SDRs allocated to India by the IMF, India's foreign exchange reserves increased by US$32.8 billion during 2009-10 to US$ 284.8billion as on October 16, 2009.

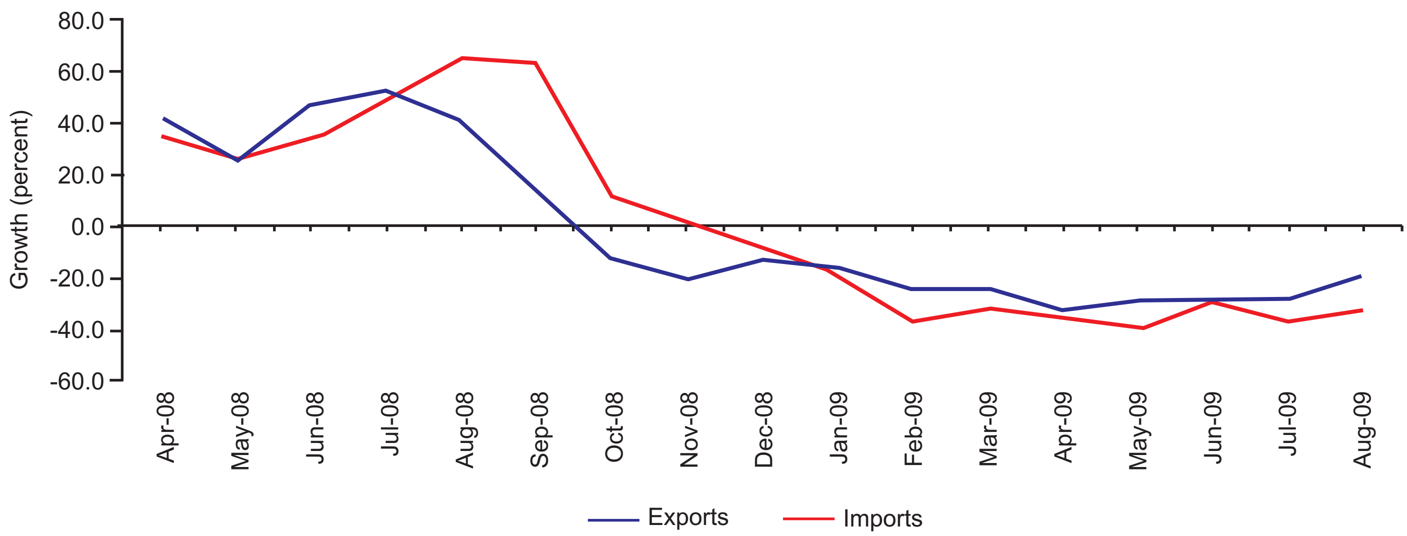

Figure 1: India's Merchandise Trade

Other Economic Indicators

- **Financial Markets:** The financial markets in India posted further decline in risk spreads and higher volume of activities. The overnight call rate hovered around the floor of the LAF corridor reflecting the abundant liquidity in the system. In the collateralized segments, namely market repo and collateralized borrowing and lending obligation (CBLO), the interest rates remained below the inter-bank call rates while there was increase in activities. Volumes in the CP and CD markets also increased. In the government securities market, 80.4% of the net borrowing requirement has been completed so far; demand for credit in the private sector and comfortable liquidity conditions helped in containing the pressures on yield. Corporate bond yields hardened somewhat but the risk spread fell to the pre-Lehman levels.

- **Credit Markets:** The gradual moderation in lending and deposit rates continued through the H1 (2009-10), demonstrating the transmission of lower policy rates. Despite some reduction in interest rates, the flow of credit to the private sector remained sluggish due to subdued overall private consumption and investment demand. Credit card and consumer durables related credit exhibited negative growth, corroborating the impact of significant deceleration in private consumption demand.

- **Inflation:** The sharp decline in headline WPI inflation yielded space for adoption of growth-supportive accommodative monetary policy to mitigate the impact of the crisis. After remaining negative for 13 consecutive weeks, WPI inflation turned modestly positive in September 2009. Despite the low headline (year on year) WPI inflation at 1.2% (as on October 10, 2009), inflationary pressures have started to emerge, with WPI showing 5.9% increase over March 2009 and CPI inflation remaining stubbornly elevated at double digit levels. The changing inflation environment, however, is being driven by strong escalation in the prices of food articles, which have increased by 14.4% (year-on-year) so far. Excluding food items, the WPI inflation remains depressed at (-) 3.4%. This suggests both short supply as well as inefficient distribution channels.

Global Economic Conditions

- After a series of successive and frequent downward revisions to the growth outlook of the world economy for 2009 from (+) 3.9% in July 2008 to (-) 1.4% in July 2009, for the first time, the revised projected growth outlook at (-) 1.1%, points upwards in October 2009, indicating emerging signs of recovery. The recovery is expected to be led by emerging market economies (EMEs), particularly from Asia such as China, India, Singapore, Indonesia, Korea, Malaysia and Thailand.

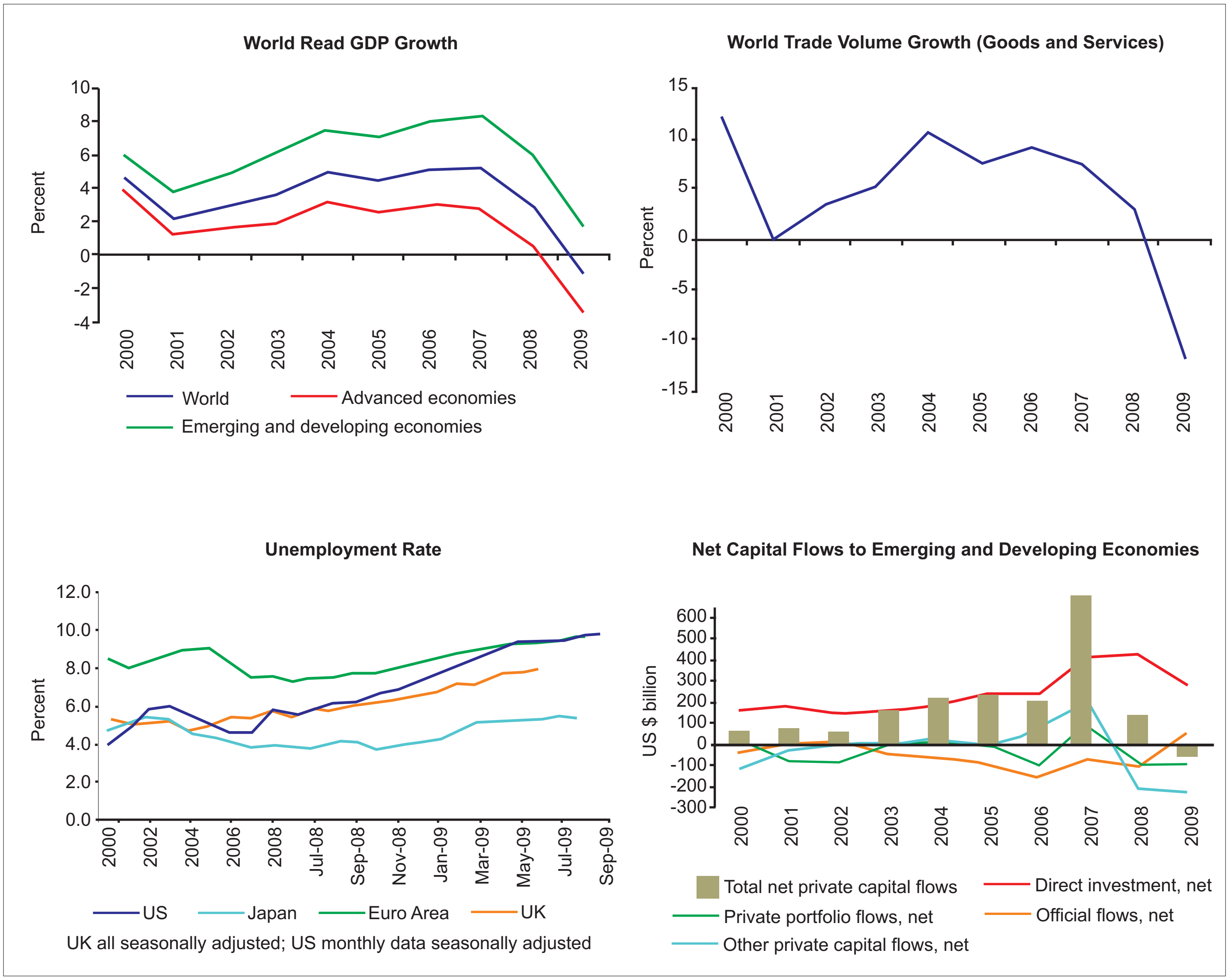

Figure 2: Key Global Indicators

- World merchandise exports increased by about 8% in Q2 (2009) over Q1 even though y-o-y growth declined by 33%.
- Net private capital flows to the EMEs, which had recovered in H1 (2009), are still only about one fourth of the peak level of net flows received in 2007. 30 EMEs are projected to receive US$ 349 billion in 2009.
- As the world gradually recovers from the global recession, it is now clear that this recovery is still dependant on sustained policy stimuli that has spurred aggregate demand while reducing overall uncertainty. The recovery will continue to remain slow and gradual.

Growth Outlook

The current growth outlook for 2009-10 has both upside prospects as well as down side risks:

Upside prospects to growth: The impact of the growth- supportive policy stimulus, recovery in industrial production and core infrastructure sector, strong recovery in the stock market with higher mobilization of resources, return of capital inflows and the improving outlook for the global economy which could boost the sluggish consumer and investor confidence.

Downside risks: The unexpectedly large deceleration in private consumption demand and some decline in corporate sales in Q1 2009-10, impact of the deficient monsoon and recent flood in certain parts of the country on agricultural output and rural demand, sustained deceleration in credit growth and decline in exports.

Financial conditions have improved significantly in India, ahead of a stronger recovery in growth. This is evident from the return of capital flows, significant recovery in the stock markets, and better transmission from low policy rates to declining lending rates. There also need be no concerns about private credit getting crowded out since over 80.4% of the government borrowing programme has been completed so far as there is adequate liquidity in the system. The deceleration in private consumption and investment demand needs to be reversed from the low levels seen in H1 (2009-10) for ensuring a sustainable recovery. Lead information in terms of growth in non-oil imports and demand for credit in H1 (2009-10) does not point to any major recovery in demand from the private sector. The overall economic outlook is, therefore, a mixture of upside prospects of recovery and downside risks. Managing this trade-off between supporting growth and reining in inflation expectations poses a key and complex policy challenge.

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