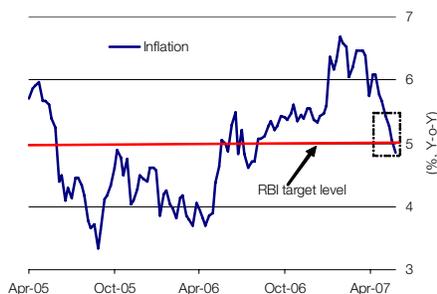


INFLATION AND EXCHANGE RATE



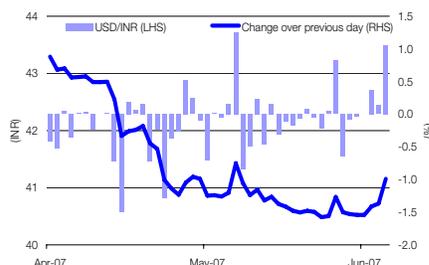
Inflation falls and rupee depreciates

Inflation falls below RBI target level



Source: Bloomberg, Edelweiss estimates

Rupee depreciates to 1 month low



Source: Bloomberg, Edelweiss estimates

June 11, 2007

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Inflation

- Inflation for the week ended May 26 fell to 4.85% Y-o-Y, below our expectations of 5.03% Y-o-Y and street expectations of 5.05% Y-o-Y. While it was largely expected that inflation will fall below the 5% mark before the end of June, the indicator has turned softer before expected.
- The softening in inflation is on account of primary articles inflation, which fell to 8.6% Y-o-Y from 9.3% during the previous week. Manufactured products inflation also fell a little to 5.14% Y-o-Y from 5.20% Y-o-Y during the previous week.
- Going forward, we expect inflation to soften further next week to 4.78% Y-o-Y. **The number will fall below 4.5% Y-o-Y before June end** (data for which will be out by mid-July).

Exchange rate

- On Friday, June 8, the USD/INR exchange rate also depreciated to 1 month low level of 41.16, from an average level of USD/INR 40.59 during June. Depreciation in the rupee was in order for a number of reasons:
- High inflation and credit growth was one of the major reasons for the RBI keeping off the currency markets. **With recent inflation releases around or below the target level, RBI intervention in the currency market was to be expected.** Intervention was particularly expected, in context of the damage to exports - a recent FICCI survey indicates that 75% of exporters surveyed are being hurt by the rising rupee.
- **The April merchandise trade numbers report the highest monthly trade deficit ever of USD 7 bn.** This is primarily on account of rising imports, while exports have so far not shown softening. Going forward, we expect the deficit to widen when the impact on exports becomes evident. This puts a **natural depreciating pressure** on the Indian rupee.
- **Domestic liquidity has been ample as indicated by soft call rates** (which fell to a low of 0.1% on June 7) **and bids received in daily reverse repo auctions** (INR 1020 bn as on June 8). **The sell off in the equity markets on Friday** is also seen as one of the reasons for a rise in rupee liquidity, allowing the currency to depreciate.
- **Going forward, we continue to expect depreciating pressure on the rupee to continue.**

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RATING INTERPRETATION

Buy	Expected to appreciate more than 20% over a 12-month period	Reduce	Expected to depreciate up to 10% over a 12-month period
Accumulate	Expected to appreciate up to 20% over a 12-month period	Sell	Expected to depreciate more than 10% over a 12-month period
Trading Buy	Expected to appreciate more than 10% over a 45-day period	Trading Sell	Expected to depreciate more than 10% over a 45-day period

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