



Economy Outlook

India in 2007-08

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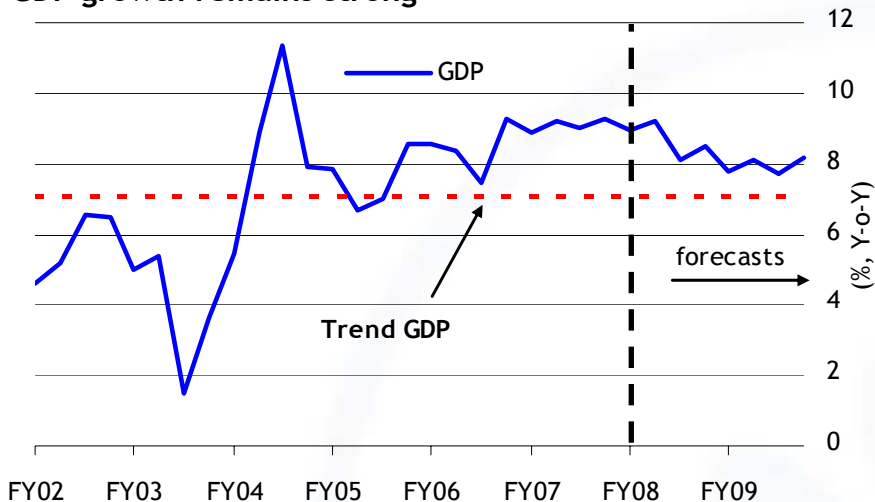
May 17, 2007

Summary: Key economic trends in FY08

- GDP growth will remain above trend in FY08 as well, though some tempering is to be expected
- Industry and services will continue to be the two pillars supporting growth
- Support from agriculture is also likely
- Continued strength in investments should sustain
- Moderation in hiring plans and expectation of capacity utilisation indicated some come off in growth
- Slowing down in credit growth is evident. This will gather pace in FY08, reflecting some tempering as well
- The policy makers will likely breathe easy on inflation
- RBI's monetary tightening cycle is close to finish, though one more round is due
- Further policy action will be a function of liquidity in the economy
- Exchange rate will be a key indicator to watch out for

#1: Growth to remain strong

GDP growth remains strong



Source: CSO, Edelweiss estimates

GDP breakup

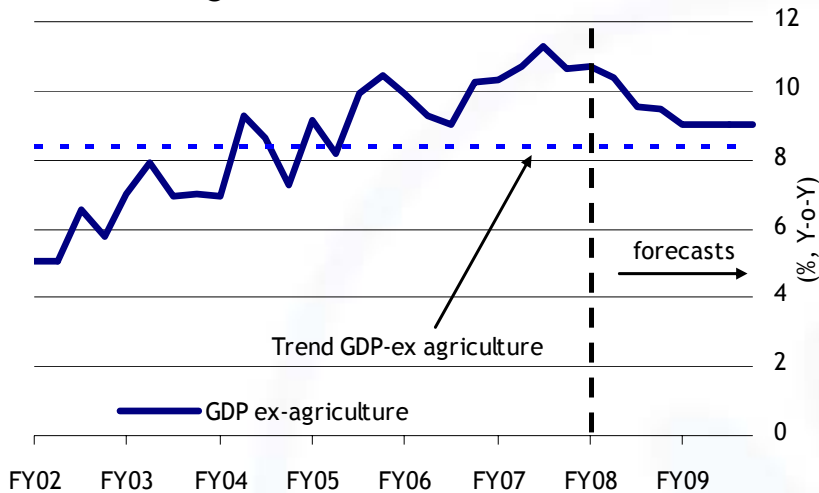
	FY07E	FY08E	FY09E
GDP	9.0	8.2	7.9
Agriculture	2.5	2.5	2.5
Industry	9.8	8.6	9.1
Services	11.0	9.9	9.0

Source: CSO, Edelweiss estimates

- Economic growth will remain above trend of 7.1% Y-o-Y in FY08
- It will, however, temper from FY07 levels
- Industry and services will continue to remain the two pillars of growth
- Agriculture support is likely to come in

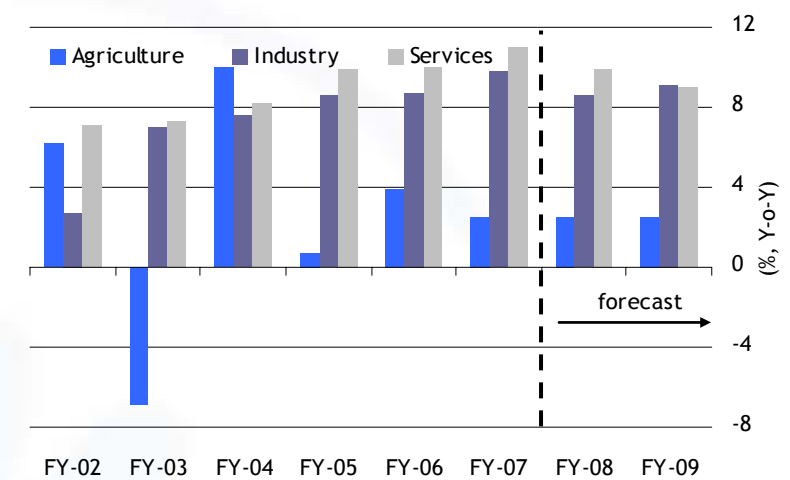
#2: Industry and services remain two pillars of GDP growth

Above trend growth



Source: CSO, Edelweiss estimates

Strength in industry and services to continue

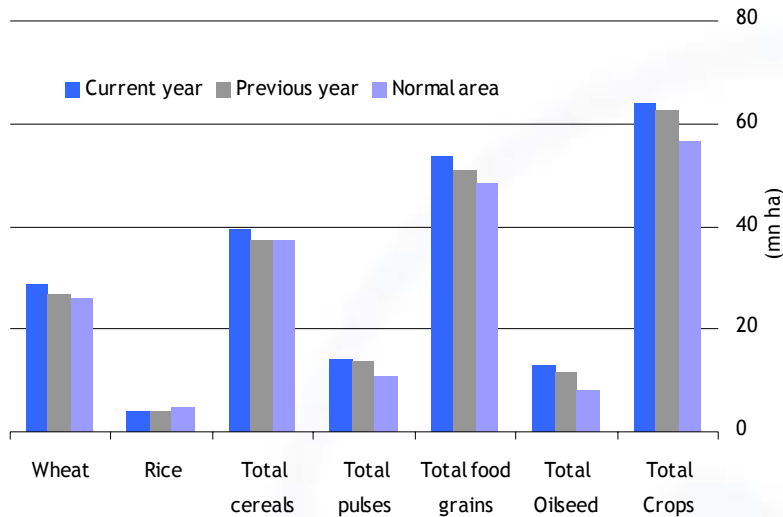


Source: CSO, Edelweiss estimates

- GDP ex-agriculture will continue to be behind strong growth
- Services to remain the growth driver
- Industry could come off more in FY08, as impact of interest rate hikes kicks in

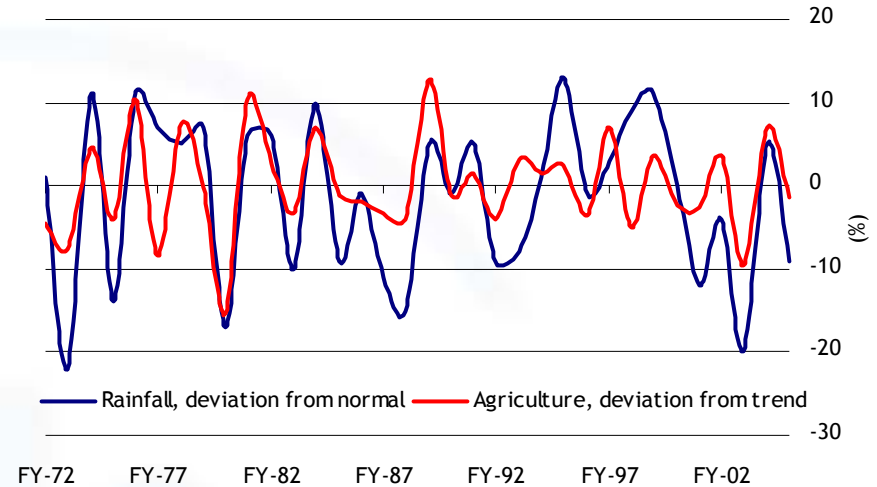
#3: Support from Agriculture likely

Rabi season crop outlook positive



Source: Ministry of Agriculture

Rains impact production

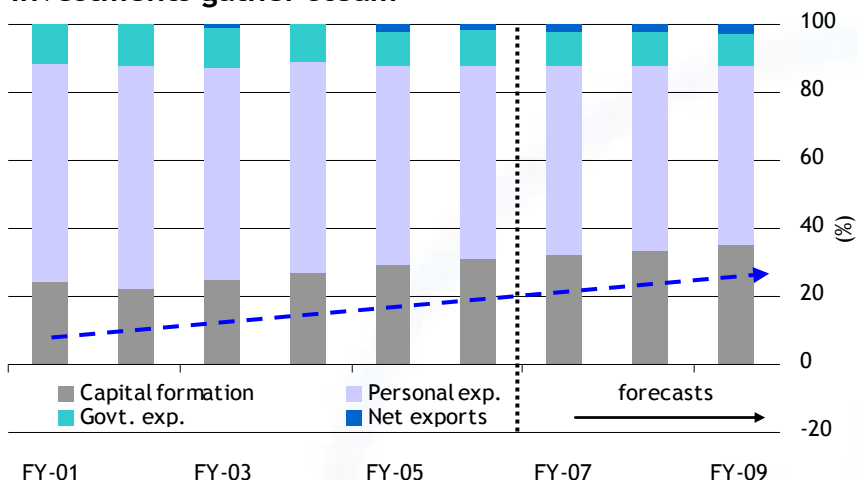


Source: CMIE, CSO

- Rabi season sowing indicates good output.
- Indian Meteorological Department (IMD) forecasts a normal south-west monsoon for 2007.
- Expectation of (i) good rabi harvest and (ii) normal rains in 2007 augurs well for agricultural growth in FY08
- Agriculture places an upward bias on our GDP growth of 8.2% Y-o-Y for FY08.

#4: Investments to add to support

Investments gather steam



Source: CSO, CMIE, Edelweiss estimates

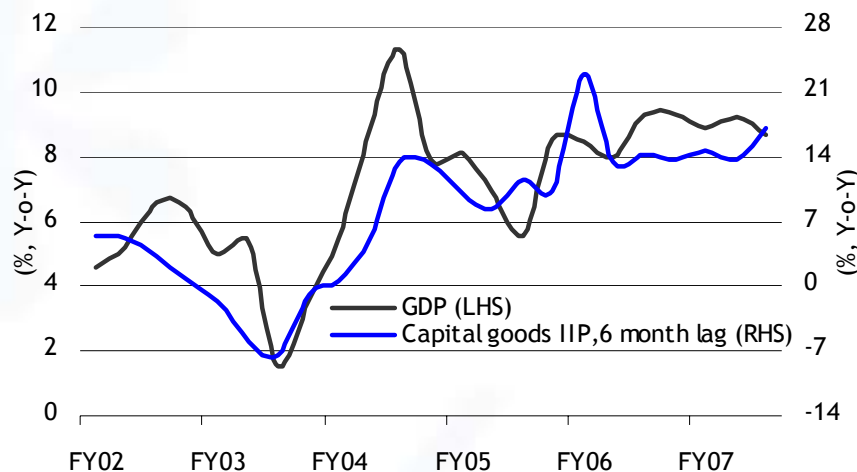
- The proportion of capital formation in GDP has been on the rise
- Capex will likely sustain going forward as well, while the share of consumption expenditure will be on the decline
- Capital goods IIP leads GDP by 6 months. Trend so far indicates sustained growth

Contribution to GDP (by expenditure)

	FY-06	FY-07E	FY-08E	FY-09E
Personal exp.	56.9	55.4	54.0	52.6
Govt. exp.	10.4	10.0	9.7	9.3
Capital formation	31.0	32.4	33.8	35.2
Net exports	1.7	2.1	2.5	2.9

Source: CMIE, CSO, Edelweiss Estimates

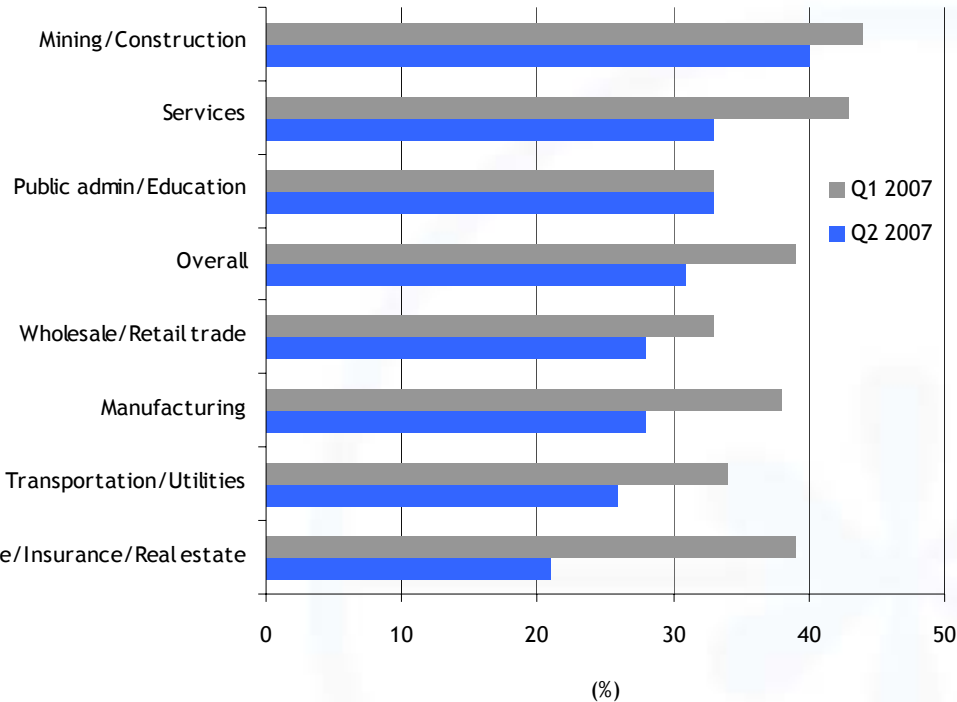
Capital goods growth augers well



Source: CSO, CMIE, Edelweiss estimates

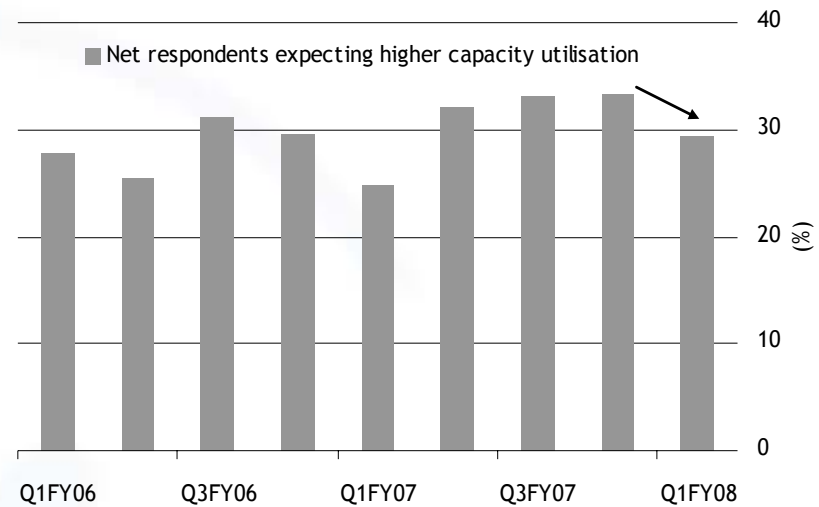
#5: Expect tempering from FY07

Hiring plans are slowing down



Source: Bloomberg, Manpower

Capacity utilisation is expected to ease

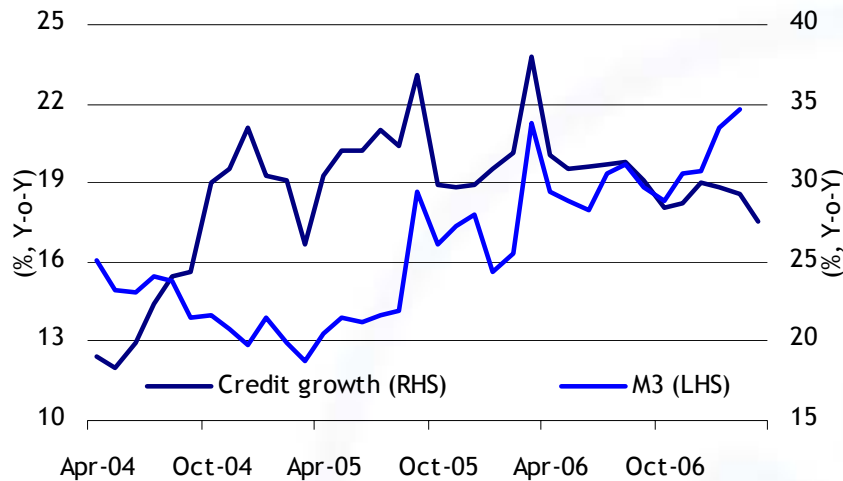


Source: RBI

- Survey indicators point to some cooling off going forward
- Hiring will likely slow down in April-June 2007 in comparison with Jan-March
- The proportion of manufacturing companies expecting capacity utilisation to rise, has declined

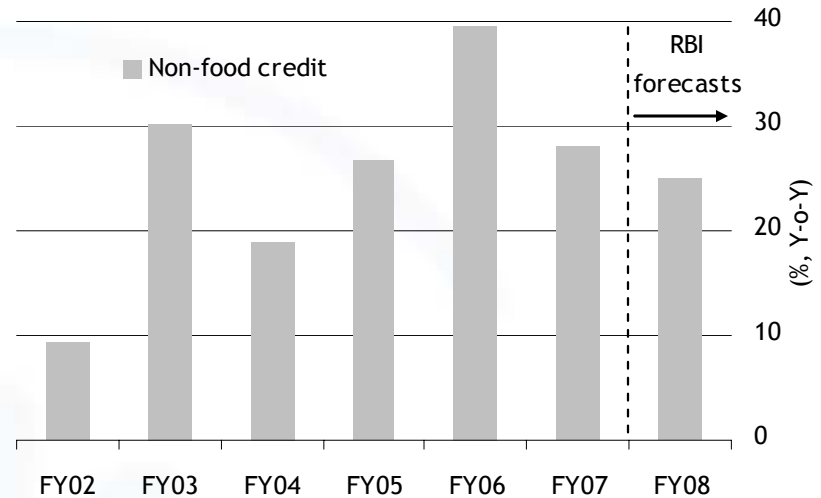
#6: Credit growth is showing signs of slow down

Credit growth softens



Source: RBI, Edelweiss estimates

Credit to cool off



Source: RBI, CMIE

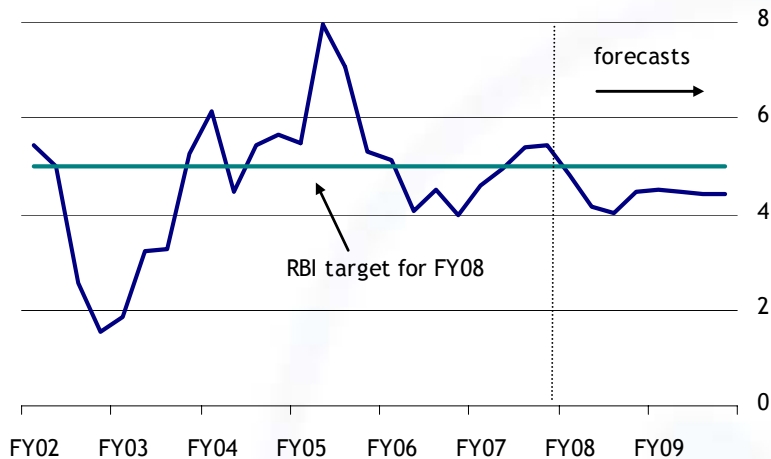
- We expect to see the impact of monetary tightening in FY-08
- Already credit growth has come off
- Credit to risky sectors in particular has declined

Credit across sectors	(% , Y-o-Y)	
	Dec-06	Dec-07
Non-food gross bank credit	33.3	31.1
Agriculture and allied activities	39.6	31.2
Industry	25.0	27.8
Real estate loans	155.4	66.7
Non-banking financial companies	59.4	24.3

Source: RBI, CMIE

#7: Inflation to cool off

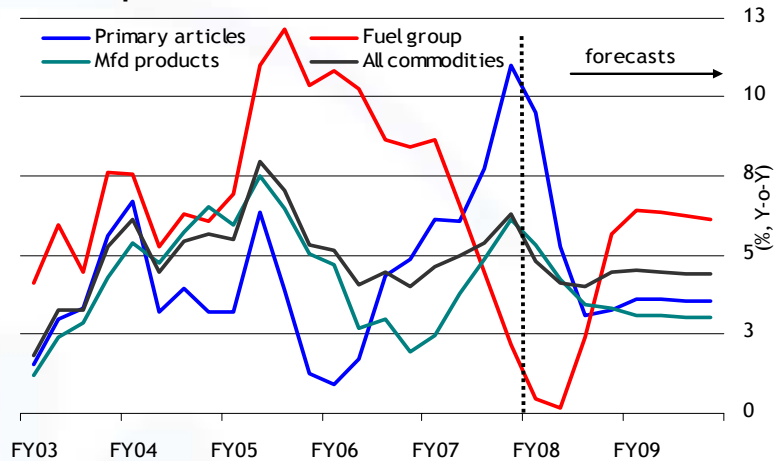
Inflation has come off, but some pain remains



Source: Bloomberg, Office of Economic Advisor, Edelweiss estimates

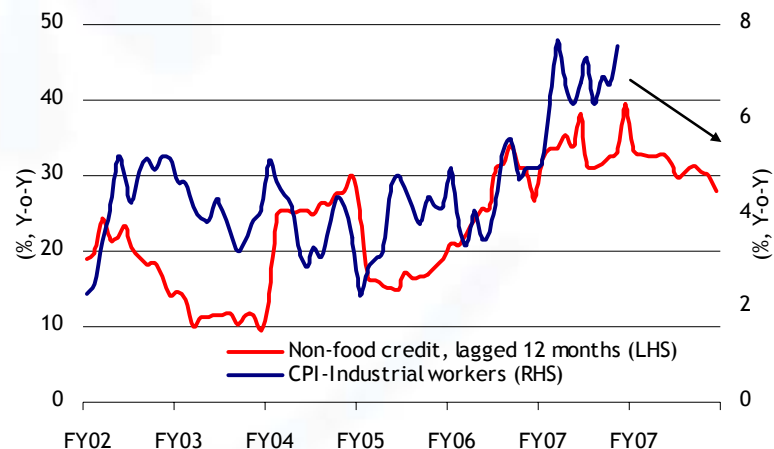
- Headline inflation is expected to come off its FY07 highs as (i) the effect of monetary and fiscal policy action kicks in (ii) low base effect wears off
- We expect inflation to fall below 5% in the remaining part of Q1 FY08 and forecast the FY08 average at 4.36% Y-o-Y.
- CPI inflation likely to come off too. It broadly lags non-food credit growth by 12 months

All components to show subdued inflation



Source: Office of Economic Advisor, Edelweiss estimates

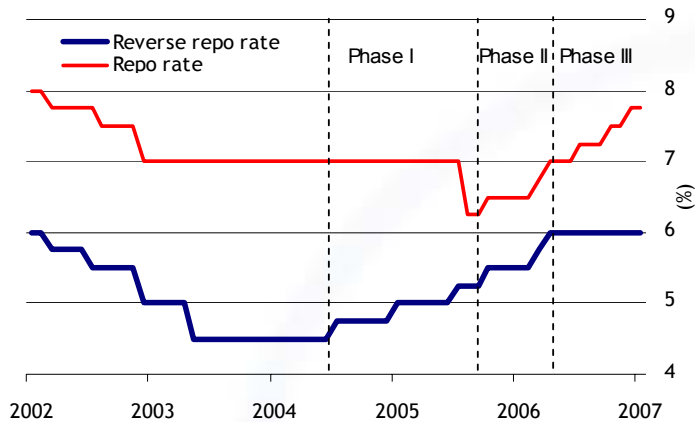
CPI inflation should come off too



Source: CMIE, Edelweiss estimates

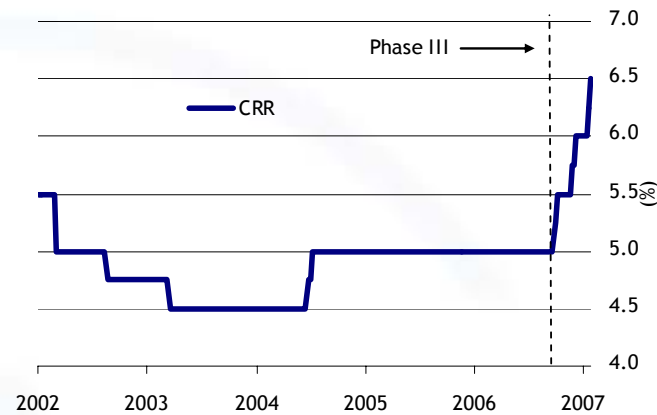
#8: Tightening cycle near its end

Preference for short-term policy rates



Source: RBI, CMIE

Aggressive CRR hikes

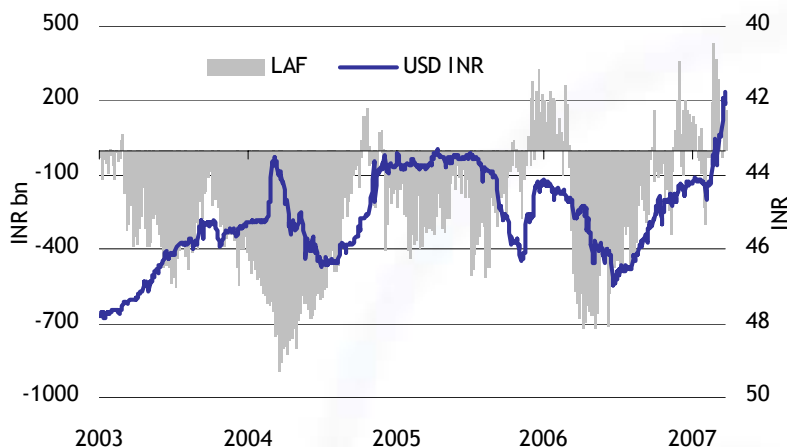


Source: RBI, CMIE

- The current tightening cycle, that began in 2004, has become increasingly aggressive over time
- The focus of monetary tightening has however moved from dealing with domestic demand to externally generated liquidity
- We believe that we are nearing the end of the current tightening cycle. We expect one more CRR hike and additionally a repo rate hike cannot be ruled out either. Further monetary policy actions will likely be determined by liquidity conditions.

#9: Liquidity management to acquire focus

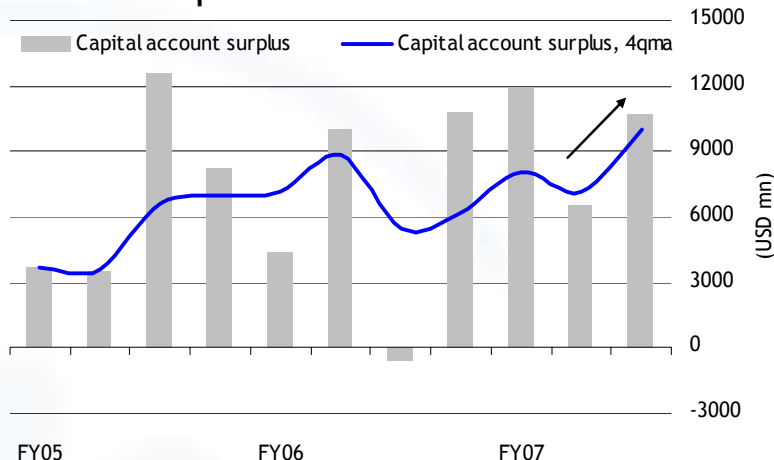
Liquidity and exchange rates are closely correlated



Source: RBI, Bloomberg

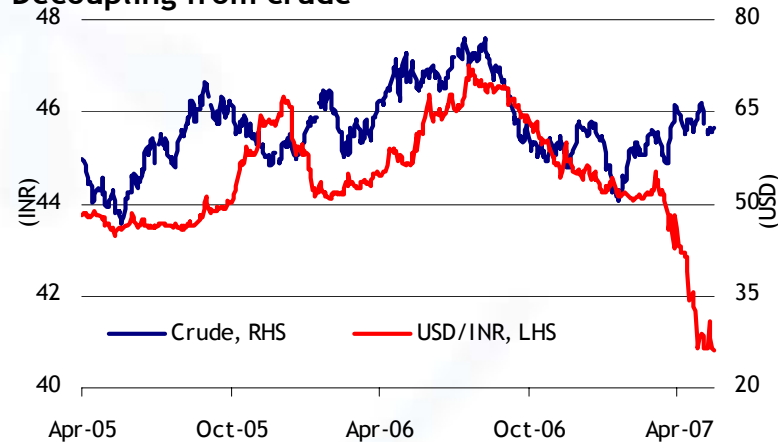
- Externally generated liquidity is a key concern for the central bank, as evident from the current hands-off approach by RBI in the currency markets
- Strong foreign flows and stability in crude prices are expected to put upward pressure on the exchange rate.
- We believe that its only a matter of time before the central bank intervenes in the currency markets.

Robust capital flows



Source: RBI, Edelweiss estimates

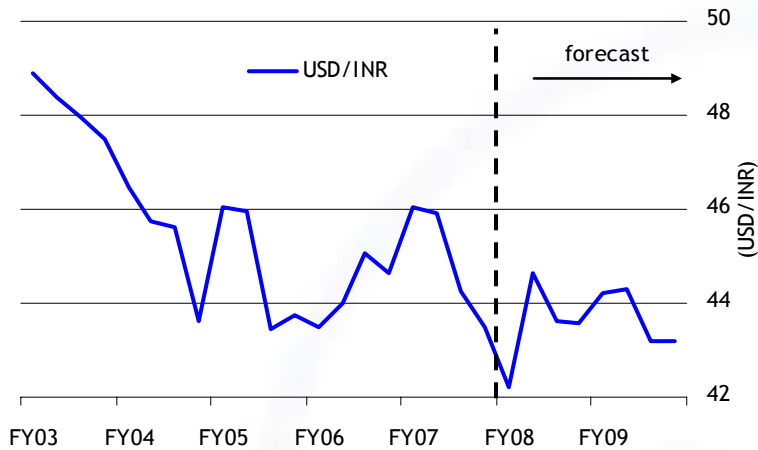
Decoupling from crude



Source: Bloomberg

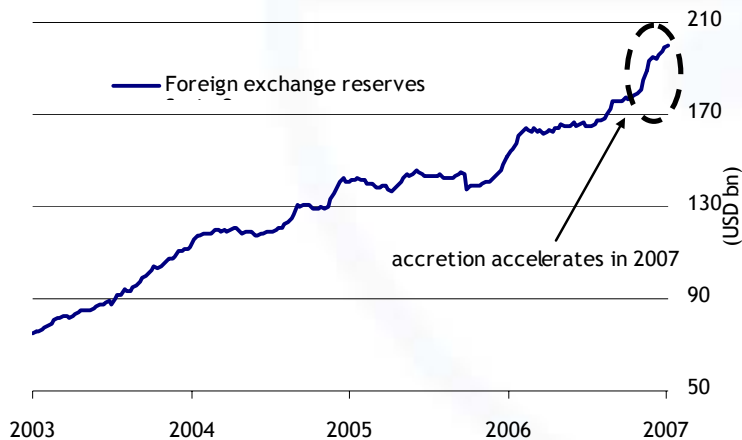
#10: Exchange rate is the key indicator to watch out for

Rupee continues to appreciate



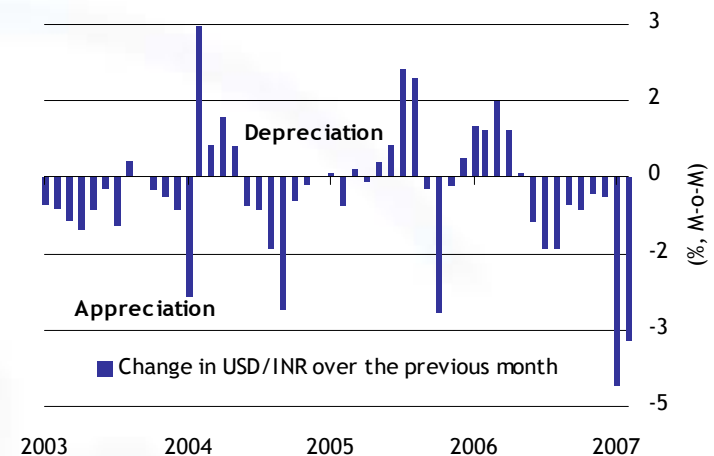
Source: Bloomberg, Edelweiss estimates

Reserve accretion continues



Source: RBI, Edelweiss estimates

Sharp rise in FY08



Source: Bloomberg, Edelweiss estimates

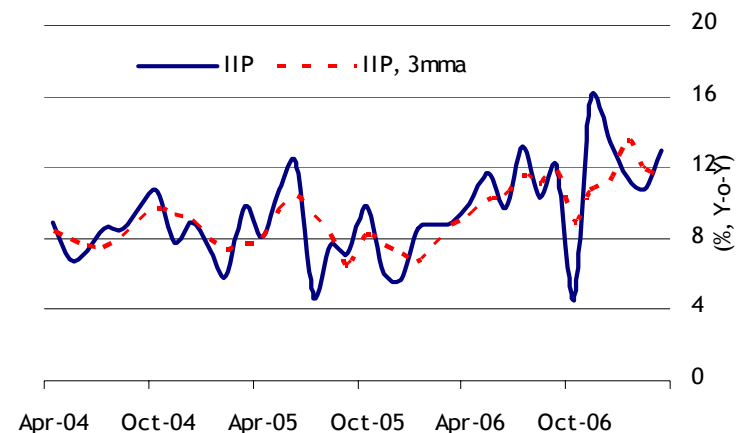
- The rupee has appreciated sharply since the start of FY08 as the RBI has steered clear of the currency markets.
- We expect to see a depreciation from the current levels. Average FY08 levels are likely to range between 43.5-44.0.

Conclusion

- India is expected to continue to show strong growth in FY08 and FY09 as well. Agriculture will likely provide support this year, and investments will stay strong.
- Credit and inflation are expected to cool off, allowing the central bank to be less hawkish.
- Key indicator to watch out for in India is the exchange rate. Further tightening will likely be a function of RBI intervention in currency markets.

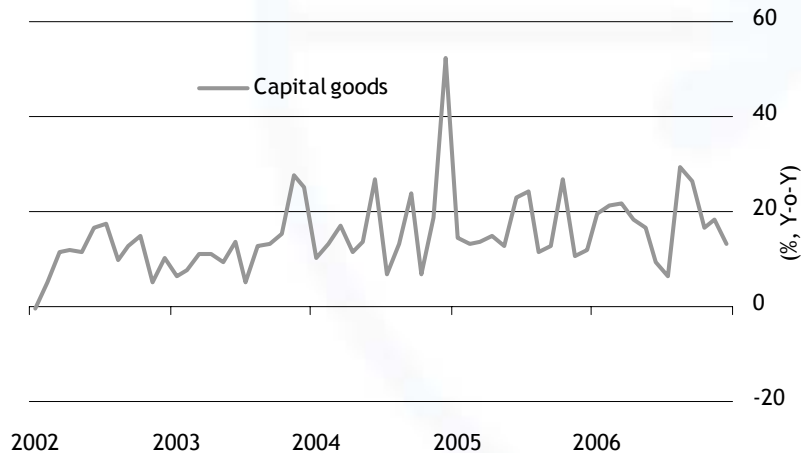
Annexure: Key indicators - industrial production

Strong industrial production sustained



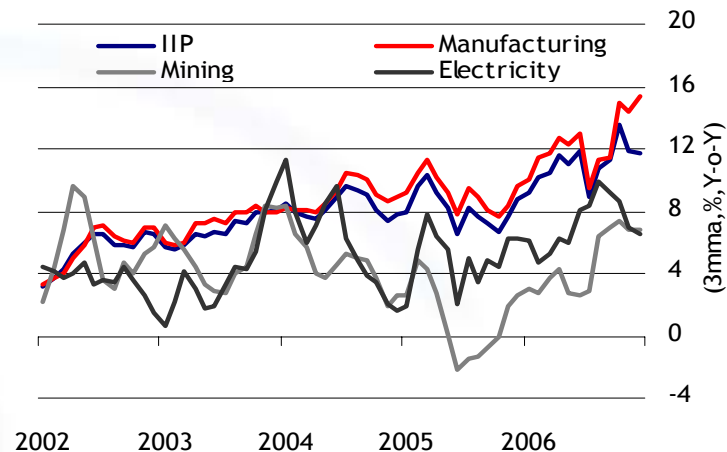
Source: CMIE, Bloomberg, Ministry of commerce

Capital goods still at double digit growth



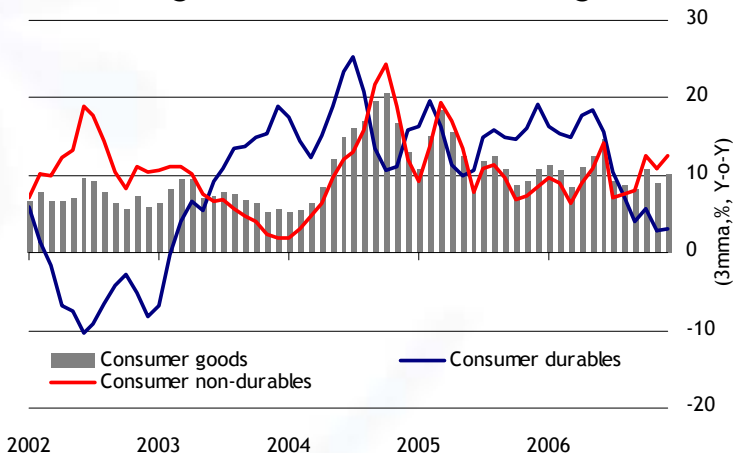
Source: CMIE, Bloomberg, Ministry of commerce

Manufacturing leads IIP growth



Source: CMIE, Bloomberg, Ministry of commerce

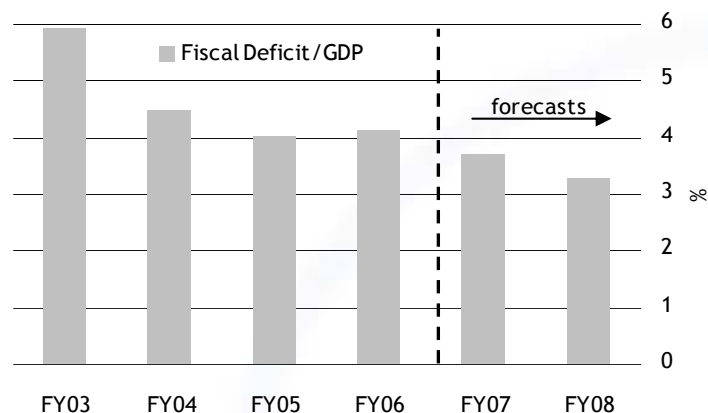
Consumer goods shows some softening



Source: CMIE, Bloomberg, Ministry of commerce

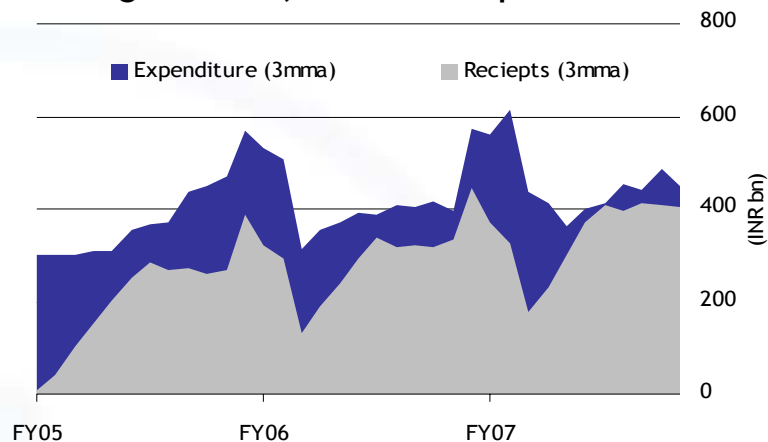
Annexure: Key indicators - government finances

Fiscal deficit to remain contained



Source: CMIE, Comptroller general of accounts

Strong revenues, contained expenditure



Source: CMIE, Comptroller general of accounts

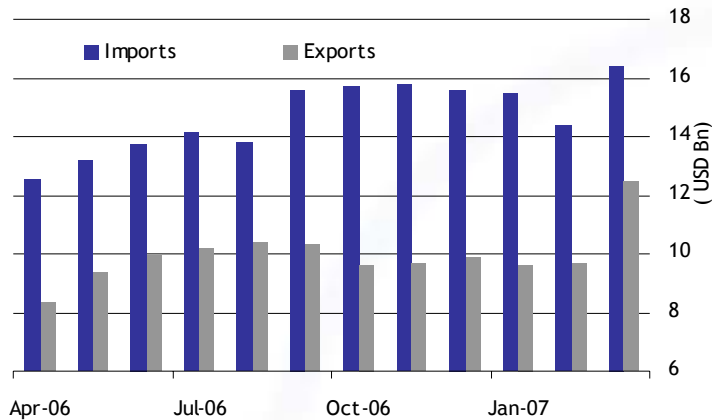
Tax revenues	(INR bn)		
	FY07 (B.E)	FY07 (R.E)	FY08 (B.E)
Gross tax revenue	4,421	4,678	5,481
Excise	1,190	1,173	1,302
Customs	771	818	988
Corporation tax	1,330	1,465	1,684
Income tax	774	825	988
Service tax	345	382	502

Source: Budget document 2007-08

Expenditure	(INR bn)		
	FY07 (B.E)	FY07 (R.E)	FY08 (B.E)
Non plan expenditure	3,913	4,089	4,754
Revenue	3,444	3,622	3,835
Capital	468	467	919
Plan expenditure	1,727	1,727	2,051
Revenue	1,438	1,446	1,744
Capital	290	281	307
Total expenditure	5,640	5,816	6,805

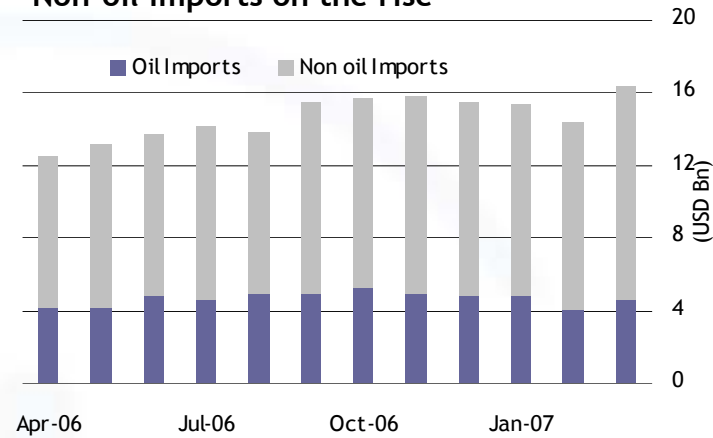
Source: Budget document 2007-08

Goods trade rebounds in March



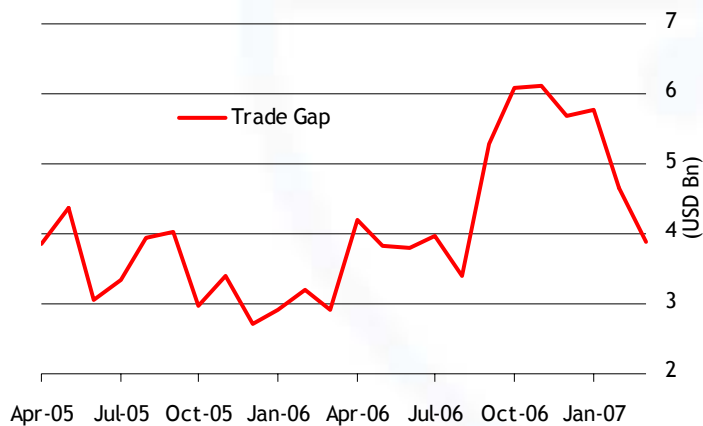
Source: CMIE, Bloomberg, Ministry of commerce

Non-oil imports on the rise



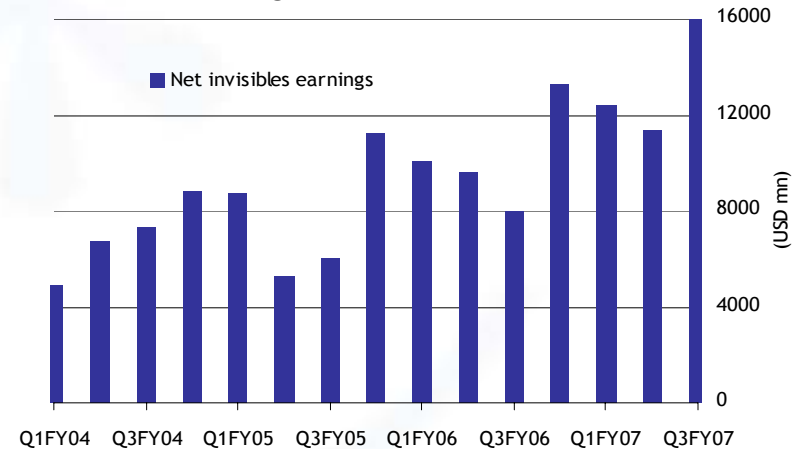
Source: CMIE, Bloomberg, Ministry of commerce

Trade deficit declines



Source: CMIE, Bloomberg, Ministry of commerce

Invisibles earnings on the rise



Source: CMIE, Bloomberg, Ministry of commerce

Annexure: Key indicators - Balance of Payments

Balance of Payments

	FY03	FY04	FY05	FY06	Q1FY06	Q2FY06	Q3FY06	Q4FY06	Q1FY07	Q2FY07	Q3FY07
I. MERCHANDISE	-10690	-13718	-33702	-51,554	-13,604	-14,632	-11,837	-11,481	-18,484	-16,057	-19,021
a) Invisible earnings	17035	27801	31232	40,942	10,048	9,587	8,011	13,296	12,385	11,375	15,979
Exports	3578	10116	15436	22,440	5,389	6,189	4,450	6,412	7,603	7,521	9,004
Software services earnings	8863	12324	16900	22,262	4,853	4,989	5,755	6,665	5,947	6,678	6,864
b) Transfers	16838	22162	20785	24,276	5,503	4,990	6,436	7,347	5,735	5,222	8,032
c) Income	-3446	-4505	-4979	-5,599	-827	-1,542	-2,857	-373	-925	-1,306	-1,046
Total current account	6345	14083	-2470	-10,612	-3,556	-5,045	-3,826	1,815	-6,099	-4,682	-3,042
B. CAPITAL ACCOUNT											
1. Foreign Investment (a+b)	4161	13744	13000	18,222	2,170	5,522	4,160	6,370	1,200	4,409	5,837
a) Foreign Direct Investment (i+ii)	3217	2388	3713	5,733	1,198	1,086	1,412	2,037	1,727	2,268	2,281
b) Portfolio Investment	944	11356	9287	12,489	972	4,436	2,748	4,333	-527	2,141	3,556
2. Loans (a+b+c)	-3850	-4364	10909	4,737	1,152	3,064	-3,045	3,566	4,000	3,215	3,747
a) External Assistance	-3128	-2858	1923	1,438	212	183	477	566	23	337	556
b) Commercial Borrowings (MT<)	-1692	-2925	5194	1,591	1,091	1,758	-4,281	3,023	3,560	1,324	3,833
c) Short Term to India	970	1419	3792	1,708	-151	1,123	759	-23	417	1,554	-642
3. Banking Capital (a+b)	10425	6033	3874	1,373	782	1,996	-978	-427	5,079	-1,828	-2,055
a) Commercial Banks	7447	2391	3979	442	666	1,891	-1,445	-670	4,918	-1,784	-2,052
of which : Non-Resident Deposits	2978	3642	-964	2,789	-108	341	881	1,675	1,231	798	1,172
b) Others	0	0	-105	931	116	105	467	243	161	-44	-3
4. Rupee Debt Service	-474	-376	-417	-572	-142	0	-285	-145	-67	-	-2
5. Other Capital	578	1699	656	933	466	-566	-458	1,491	1,651	781	3,205
Total Capital Account (1to5)	10840	16736	28022	24,693	4,428	10,016	-606	10,855	11,863	6,577	10,732
C. Errors & Omissions	-200	602	607	971	375	285	-240	551	614	373	-185
D. Overall Balance	16985	31421	26159	15,052	1,247	5,256	-4,672	13,221	6,378	2,268	7,505

Source: RBI

Annexure: Key indicators - Economy datasheet

Economy datasheet

	Apr-06	May-06	Jun-06	Jul-06	Aug-06	Sep-06	Oct-06	Nov-06	Dec-06	Jan-07	Feb-07	Mar-07	Apr-07
Industrial production													
IIP (%Y-o-Y)	9.9	11.7	9.7	13.2	10.3	12.0	4.5	15.8	13.4	11.4	10.8	12.9	
Mining	3.4	2.9	4.7	5.1	-1.7	4.3	5.9	8.8	6.1	7.2	7.1	6.2	
Electricity, gas and water supply	5.9	5.0	4.9	8.9	4.1	11.3	9.7	8.7	9.1	8.3	3.3	7.9	
Manufacturing	11.0	13.3	10.7	14.3	11.9	12.7	3.8	17.2	14.5	12.1	11.9	14.1	
Use based													
Basic goods	9.3	9.2	8.5	10.0	4.8	11.5	10.5	12.1	12.4	11.8	10.6	11.4	
Capital goods	19.6	21.4	21.6	18.3	16.6	9.5	6.5	29.4	26.2	16.6	18.5	13.2	
Intermediate goods	8.5	12.5	11.2	10.7	8.7	13.8	5.9	17.9	12.7	13.0	12.2	13.3	
Consumer goods	8.9	10.5	6.1	16.8	15.0	12.1	-2.8	13.5	10.7	8.5	7.6	14.2	
Infrastructure indicators													
Infrastructure index (%Y-o-Y)	7.1	7.1	7.7	10.8	6.5	10.5	9.8	9.5	8.5	8.2	7.5	10.1	
Electricity	5.9	5.1	4.9	8.9	4.1	11.5	9.7	8.7	9.3	8.5	3.3	8.0	
Coal	3.4	8.1	12.0	10.6	0.2	-0.7	2.1	4.9	2.9	10.0	6.6	10.7	
Steel	9.6	10.7	10.2	13.9	9.3	10.4	10.4	9.1	10.0	8.3	13.4	15.0	
Cement	12.2	6.8	11.7	14.0	2.9	16.5	9.4	11.8	8.0	7.2	5.8	5.5	
Crude petroleum	-1.8	1.0	1.2	4.1	12.1	9.4	9.3	9.8	10.7	4.7	4.9	3.2	
Refined petroleum	13.1	12.1	10.6	12.6	12.1	13.4	18.1	16.4	6.2	9.2	11.3	13.4	
Cargo traffic at ports (mn tonnes)	32.3	37.8	36.6	35.6	35.6	35.6	35.6	35.6	35.6	35.6	35.6	35.6	
GSM subscribers (in mn)	72.1	75.2	78.4	82.4	82.4	82.4	82.4	82.4	82.4	82.4	82.4	82.4	
Railways goods traffic, rev. (INR bn)	33.3	33.6	32.7	32.6	33.6	34.6	35.6	36.6	37.6	38.6	39.6	40.6	
Inflation													
WPI (%Y-o-Y)	3.5	4.4	5.0	4.6	4.8	5.2	5.1	5.3	5.4	6.2	6.4	6.3	5.9
Primary articles	3.6	5.0	6.9	4.5	6.1	7.9	6.7	6.7	8.6	9.7	11.6	11.6	11.7
Fuel, light, power and lubricants	8.1	9.1	8.6	7.4	5.9	5.0	5.5	5.3	3.6	3.7	1.8	1.2	1.1
Manufactured products	1.6	2.4	2.9	3.6	3.8	4.1	4.3	4.8	4.8	5.8	6.2	6.4	5.6
CPI, IW (%Y-o-Y)	5.3	6.1	7.9	6.9	6.0	6.8	7.6	6.7	6.7	7.6	6.7	6.7	
Government finances													
Fiscal deficit, cumulative (INR bn)	320	721	777	864	951	865	871	1,082	948	1,110	1,218		
Monetary indicators													
Money supply (M3) (%Y-o-Y)	18.7	18.4	18.1	19.5	19.7	19.1	18.6	19.4	19.4	21.1	21.8	20.7	19.8
Bank credit (INR bn)	14,858	14,931	15,451	15,569	15,861	16,547	16,556	16,837	17,663	17,806	18,202	19,232	18,896
Food credit	373	391	380	361	364	335	366	387	422	421	439	465	499
Non-food credit	14,485	14,541	15,071	15,208	15,498	16,213	16,189	16,451	17,242	17,386	17,763	18,767	18,397
Credit-deposit ratio	69.6	69.9	70.8	70.6	71.0	71.9	72.2	72.2	74.0	74.0	73.8	74.1	72.7
External sector													
Foreign trade													
Exports (USD bn)	8.3	9.4	10.0	10.2	10.4	10.3	9.6	9.7	9.9	9.6	9.7	12.5	
Imports (USD bn)	12.6	13.2	13.8	14.1	13.8	15.6	15.7	15.8	15.6	15.4	14.4	16.4	
Trade balance (USD bn)	-3.9	-4.3	-3.6	-4.0	-4.1	-6.0	-6.9	-5.4	-5.7	-5.8	-4.7	-3.8	
Forex reserves (USD bn)	161	163	163	164	166	167	167	176	177	181	194.6	199.1	204.1

Source: Bloomberg, CGA, CMIE, Ministry of Commerce and Industry, Edelweiss estimates

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