

MACRO METER

Policy rates unchanged, credit and inflation cool off

* Policy moves

- ◆ The RBI annual policy meeting was a non-event. The central bank kept key rates unchanged as credit growth came off and inflation is expected to decline. It has however hinted at further policy tightening going forward.

* Strong real activity continues

- ◆ IIP numbers surprised to the upside yet again in March. Industrial production grew by 12.9% Y-o-Y on strong growth in manufacturing and consumer goods.

* Inflation

- ◆ WPI inflation continues to cool off. For the week ended April 28 it was at 5.66% Y-o-Y. A favorable base effect and impact of policy measures are expected to positively impact inflation numbers.

* Monetary developments

- ◆ Credit growth, deposits growth and credit-deposit ratio declined in April end.
- ◆ Liquidity situation remains largely stable, with the RBI conducting its reverse-repo auctions. Repo auctions took place for some time when the CRR hikes kicked in.

* External sector

- ◆ Trade showed robust performance in March.
- ◆ Rupee continued to appreciate as the RBI maintained a hands off approach.

Economy snapshot

Indicator	FY-05	FY-06	FY-07(YTD)
Real GDP (% Y-o-Y)	7.5	8.4	8.9
Agriculture	0.7	3.9	2.2
Industry	8.6	8.8	10.1
Services	9.9	10.1	11.1
Credit (% Y-o-Y)	32.6	32.3	30.3
M3 (% Y-o-Y)	14.4	17.0	19.5
WPI inflation	5.7	3.5	5.4
Imports (USD bn)	107	134	176
Exports (USD bn)	79	94	120
Current account balance (USD bn)	(5.4)	(10.6)	(13.8)
Capital account balance (USD bn)	31.0	25.6	29.7
Fiscal deficit/GDP (%)	4.0	4.1	5.2

Source: Bloomberg, CSO, RBI, Office of Economic Advisor

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* **RBI policy – non event**

Announcements

The RBI kept key policy rates unchanged at the April policy meeting. Other policy announcements can be broadly divided into three categories

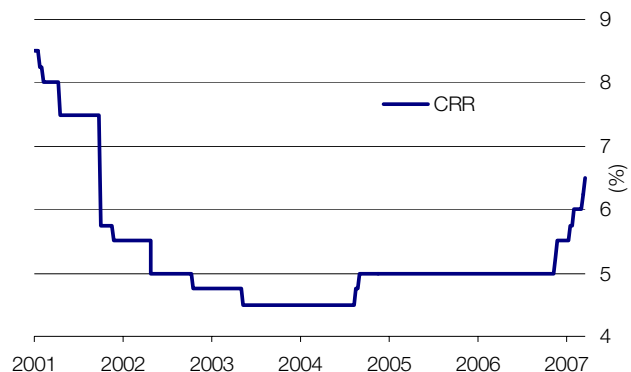
- ◆ The issue of capital flows was addressed (disincentives for NRI deposits, and encouragement of Indian investment overseas)
- ◆ The RBI has tried to keep small savers from getting harmed by monetary tightening (reduction in risk weightages)
- ◆ Futures markets development in focus (working group to be set up for development of interest rate futures market and making currency futures operational)

Our view on the policy

- ◆ A first look suggests that there is markedly lesser hawkishness on part of the RBI in contrast with what we have observed over the previous few quarters. This is also evident in RBI lowering its inflation to 4-4.5% for FY08 down from 5-5.5% for FY07. It also expects relatively benign credit growth.
- ◆ Comfort on capital account convertibility evident from the easing of Indian investments overseas. This easing is likely on account of (i) RBI’s strong foreign exchange reserve (ii) flow of long-term capital like FDI into the economy and (iii) a means to check the unabated appreciation of the rupee.

- ◆ Monetary policy stance is unchanged from the previous quarter. Inflation and credit quality are key indicators to watch out for.
- ◆ We do not think we have seen the end of tightening. This is evident from the fact that RBI has maintained its stance to “respond swiftly with all possible measures as appropriate” to the evolving global and domestic situation impinging on inflation expectations and the growth momentum”. From past policy announcements, we have observed that this particular stance is followed by inter-meeting hikes.
- ◆ The next move is likely to be dependent on how (i) credit growth and inflation situation evolves and (ii) exchange rate movements. We would place our bets on a CRR hike before June 30. Additionally, further hikes in the repo rate can not be ruled out either.

More tightening in store

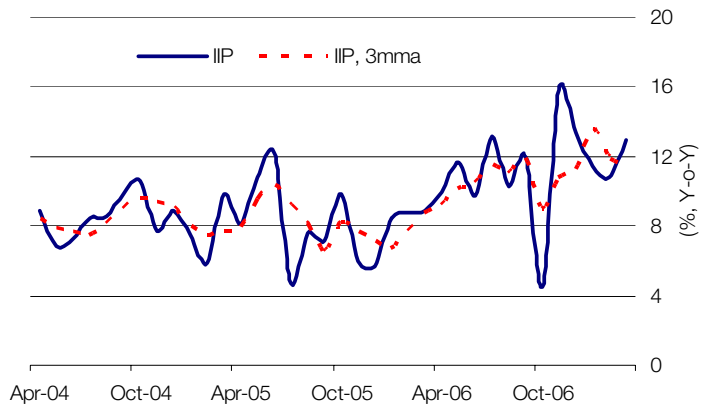


Source: CSO, Bloomberg

*** Industrial production shows surprise rise**

- ◆ India's IIP grew by 12.9% Y-o-Y in March, the fastest growth in four months. It is far higher than both our and consensus expectations which placed growth at 10.4% Y-o-Y. The March numbers put average FY07 growth at 11.3% Y-o-Y, the fastest since FY96.
- ◆ The surprise upside in March, came from strong manufacturing and electricity production (as per classification by economic activity). Mining production slowed down. As per classification by use-based category, consumer goods production strengthened. Consumer durables softened while non-durables showed a steep rise within the consumer goods category. Basic goods and intermediate goods showed rose too, while capital goods' growth softened.
- ◆ Within manufacturing, the fastest growing industries were 'wood and wood products', 'metal products' and 'basic metal and alloy industries'. On the other hand, 'jute and jute products', 'leather and leather products' and 'other manufacturing' showed de-growth. Of the 17 manufacturing industries, 14 showed positive growth.
- ◆ Above trend IIP growth is a disconnect from the softening in (i) credit growth and (ii) inflation. March is likely to have been a one off spurt in growth. We expect tempering in IIP to below 10% levels in April.

IIP – strong growth



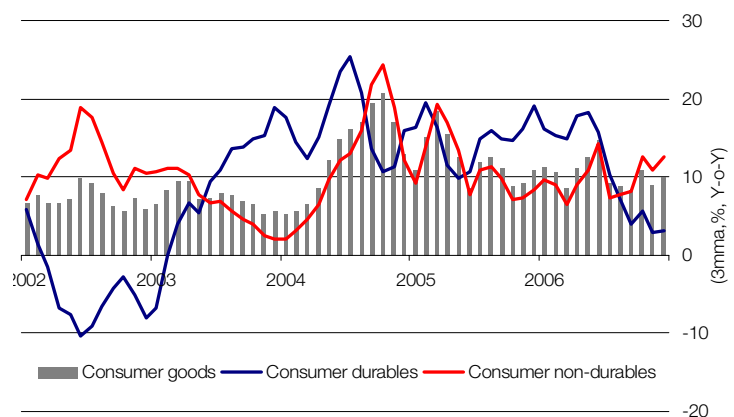
Source: CSO, Bloomberg

Manufacturing leads the way

	Feb-07	Jan-07	Feb-06
Industrial production	11.0	11.4	8.8
Manufacturing	15.4	14.4	9.2
Mining	6.3	7.2	3.8
Electricity	3.3	8.3	9.1
<i>Use-based categories</i>			
Capital goods	18.2	16.6	10.7
Consumer goods	7.6	8.5	12.5
Consumer durables	1.6	5.3	20.3
Consumer non-durables	9.7	9.5	10.1
Basic goods	10.4	11.8	9.6
Intermediate goods	13.7	13.0	2.2

Source: CSO, Bloomberg

Consumer goods strong

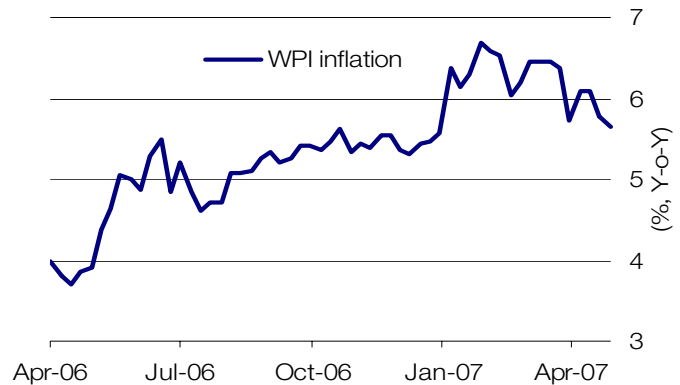


Source: Bloomberg, CSO

*** Inflation softens**

- ◆ WPI inflation has finally started coming off as a result of (i) a favourable base effect and (ii) monetary and fiscal policy measures. Average growth in April was at 5.9% Y-o-Y, down from 6.3% Y-o-Y in March.

Inflation tempers



Source: Bloomberg

- ◆ Across components, primary articles inflation has been fastest growing, though it is now showing signs of coming off. Manufactured products inflation is relatively contained, while fuel group inflation is mild.

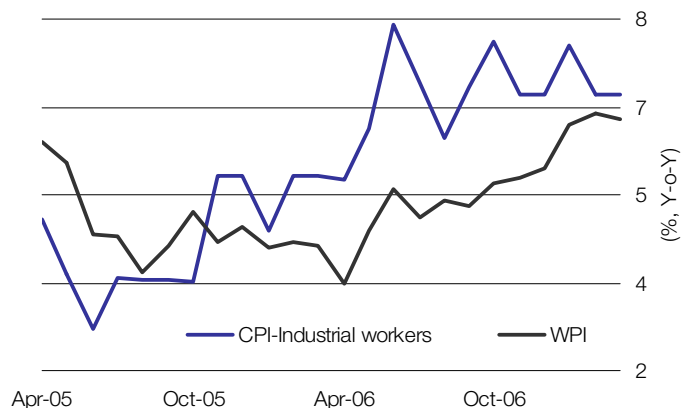
Component wise inflation

	28-Apr-07	21-Apr-07	29-Apr-06
Headline inflation	5.66	5.77	3.90
Primary articles	10.84	11.50	4.83
Fuel group	1.01	1.01	8.26
Manufactured products	5.51	5.46	1.93

Source: Bloomberg, Office of economic advisor

- ◆ CPI-IW inflation, our preferred consumer price inflation measure, has shown steady growth for two months. It grew by 6.7% Y-o-Y in both February and March. However, with a decline in WPI inflation, CPI should also come off going forward.

CPI inflation steady

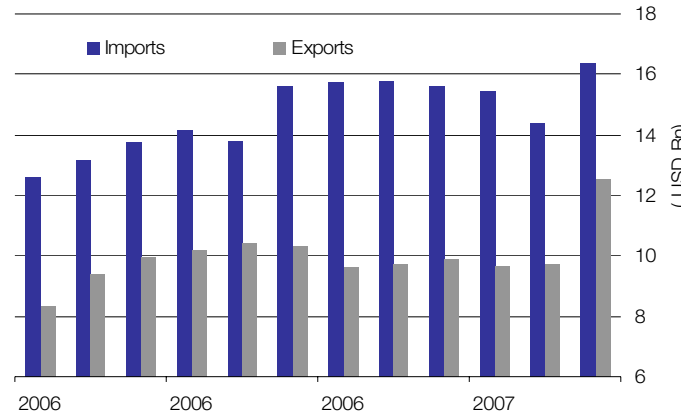


Source: Bloomberg

* Trade data – robust growth

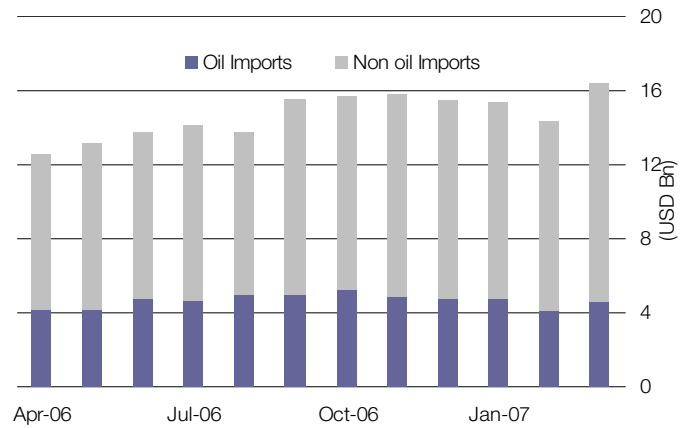
- Both exports and imports rose in March after showing a slowing trend for the five months prior to it. Imports rose to a high of USD 16.4 bn, while exports grew to USD 12.5 bn.

Trade strengthens



Source: Bloomberg

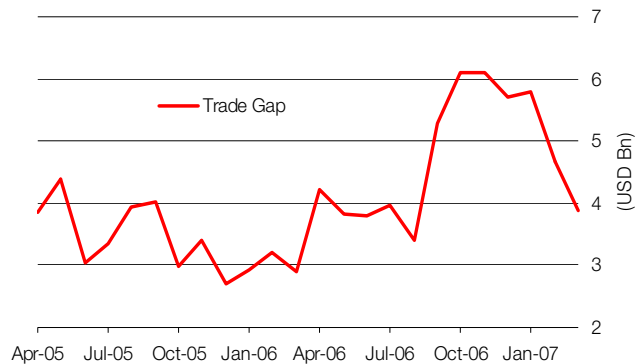
Non-oil imports on the rise



Source: Bloomberg

- Both oil and non-oil imports rose in March, but non-oil imports rose more. Of the USD 2 bn increase in total imports, non-oil imports contributed to USD 1.5 bn, while oil imports contributed to USD 0.5 bn.

Falling trade gap



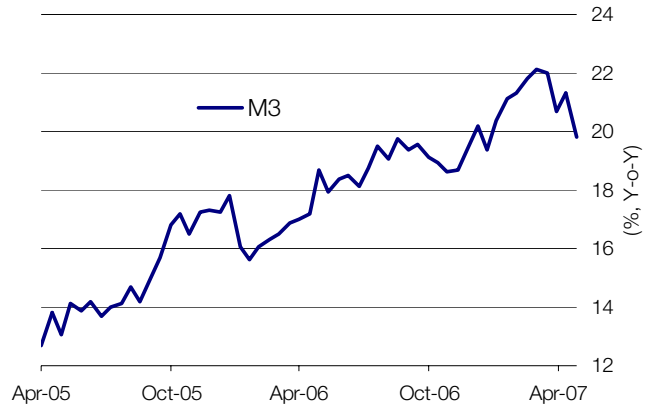
Source: Bloomberg

- Trade deficit fell for the third month in a row in March. It now stands at USD 3.9 bn, a seven month low. With appreciating pressure on the rupee, however, this trend is unlikely to last long.

*** Money supply slows down**

- Money supply growth is on the decline- it is down to 19.8% Y-o-Y for the fortnight ended April 27, 2007. This is an eight week low for M3.

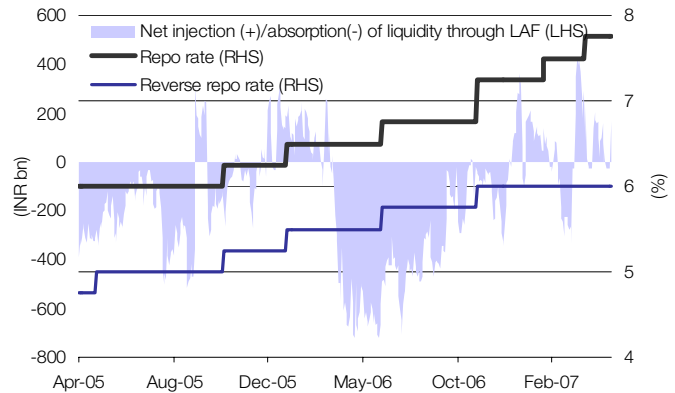
Money supply softens



Source: Bloomberg

- Liquidity has largely been in control in April and till mid-May. The RBI has resorted to repo auctions when there were tightening on account of the two stage CRR kicking in.

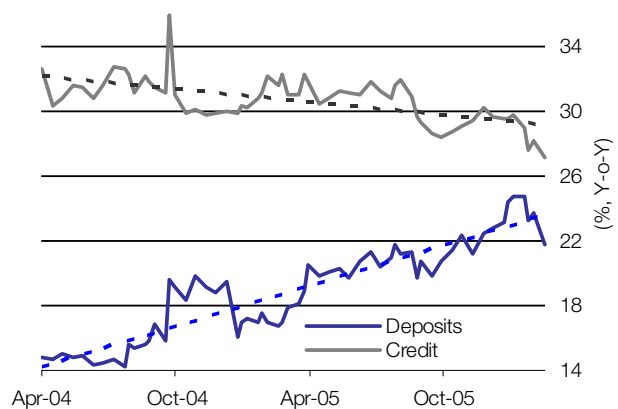
Liquidity suction



Source: RBI

- Both deposits and credit growth slowed down for the second fortnight of April. While deposits growth slowed to 21.8% Y-o-Y from 23.3% Y-o-Y in March end, credit growth is down to 27.2% Y-o-Y from 27.6% Y-o-Y in the end of March.

Deposits and credit growth dips

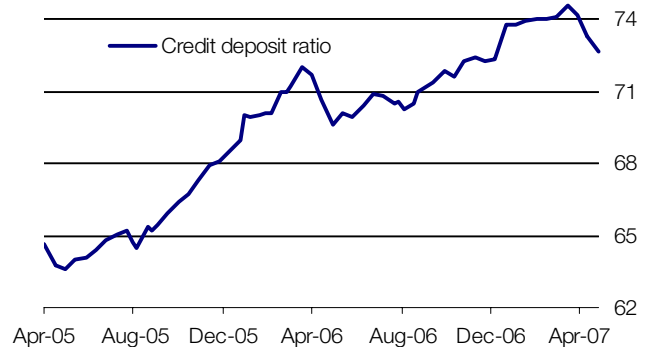


Source: Bloomberg, RBI

* **Flattish credit-deposit ratio**

- The C-D ratio declined to a 4 and a half month low on April 27, 2007 of 72.67 as credit growth continues to lose pace.

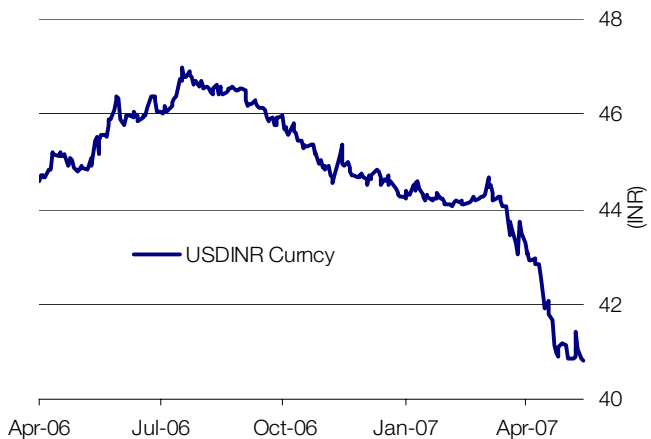
Dip in C-D ratio



Source: Bloomberg, RBI

- The USD/INR appreciated sharply in April. It was at USD/INR 41.19 in April end from USD/INR 43.47 in March end, an appreciation of 5.25%. Appreciation continues in May as well, though the pace has slowed down. It currently stands at USD/INR 40.8, an appreciation of 0.95% from the previous month.

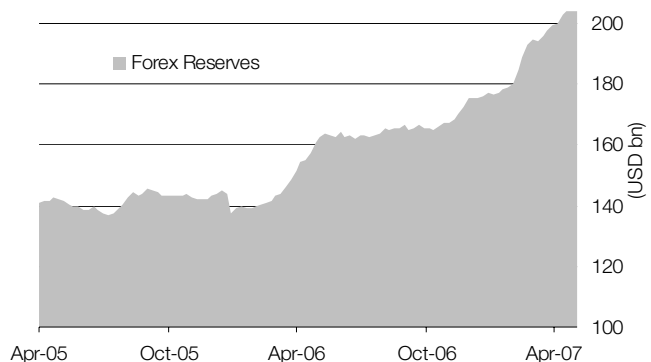
Exchange rate appreciates further



Source: Bloomberg, RBI

- Foreign exchange reserve accretion slowed down in April as the RBI refrained from intervention in the currency market. Foreign exchange reserves stand at USD 204 bn on May 4, 2007.

Foreign exchange reserves' accretion continues



Source: Bloomberg, RBI

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

	Q4FY05	Q1FY06	Q2FY06	Q3FY06	Q4FY06	Q1FY07	Q2FY07	Q3FY07
Real indicators								
GDP (% Y-o-Y)	8.6	8.5	8.4	7.5	9.3	8.9	9.2	8.6
Agriculture & allied products	1.5	3.4	4.0	2.9	5.5	3.4	1.7	1.5
Industry	8.4	10.2	7.8	8.1	8.9	9.7	10.3	9.95
Services	11.4	9.8	10.0	9.4	10.9	10.6	10.9	11.26
External sector								
Current account balance (USD bn)	0.5	(4.6)	(5.1)	(3.9)	1.8	(6.0)	(6.9)	(3.0)
Trade balance (USD bn)	(10.1)	(14.9)	(14.6)	(12.0)	(11.4)	(18.4)	(17.9)	(19.0)
Invisible balance (USD bn)	10.7	10.3	9.6	8.2	13.3	12.4	11.0	16.0
Capital account balance (USD bn)	11.8	5.4	9.9	(0.6)	11.4	11.8	8.6	10.7

Source: CMIE, RBI

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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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