

Asia Economics Data Flash

December 8, 2008

Goldman Sachs
Global ECS Asia Research
Pranjul Bhandari, Tushar Poddar

Goldman Sachs Global ECS Research
at <https://360.gs.com>

India weekly liquidity watch: Rate cut realized but credit spreads still high

Foreign exchange (FX) reserves rose by US\$2 billion to US\$247.7 billion in the week ending November 28. This was the first increase in reserves since mid-September this year and was mainly led by valuation changes following the USD's trade-weighted depreciation.

Broad money M3 growth continued to moderate to 19.0% yoy in the fortnight of November 21 vs. 19.9% yoy a month back, due to the continuing fall in the net FX assets of the banking sector, and falling credit to the commercial sector. Sequentially, M3 growth rose 1% mom in November, lower than the 2.3% mom growth in October (see Exhibit 1).

Bank credit growth slowed to 27% yoy as on November 21 compared to 29% yoy a month ago, as credit to the commercial sector continued to be difficult to obtain. Although the Prime Lending Rates (PLR) of banks have fallen to 13.25% from about 14% in September, banks have removed discounts on the PLR implying corporates are paying much higher rates now than in the last few quarters.

Liquidity conditions have eased a bit. With the deposit base remaining largely unchanged and the 350 bp cash reserve ratio cut coming into effect, free funds with banks have continued to increase and are now back at February levels after a sharp fall in October (see Exhibit 2). Banks have excess liquidity which they are parking in the reverse repo window and in government bonds.

As per our expectations, the government made an upward revision to its market borrowing plans for FY09 (see *India: Some unpleasant fiscal arithmetic*, Asia Economics Flash, October 15). It will now borrow Rs1900 billion (US\$38 billion) from the market vs. its earlier estimate of Rs1450 billion (US\$29 billion). We do not think this will put upward pressure on government bond yields, given that policy rates are on their way down and banks are still choosing to put free funds in government securities. Our estimate of the fiscal deficit is unchanged at 8.4% of GDP in FY09, with the increase in the fiscal stimulus announcement on December 7 being offset by the reductions in the oil and fertilizer subsidy bill due to falling commodity prices (see *Implications of the joint fiscal stimulus package and central bank rate cuts*, India Views, December 8).

Credit spreads are still high despite expectations of more Reserve Bank of India rate cuts. Although the 3-month MIBOR and 3-month OIS spread as well as the 3-month MIBOR and 3-month treasury spread have moved down in the last fortnight in expectation of a rate cut which finally came on board on December 6, the spreads are still at very high levels, suggesting continued credit market stress (see Exhibit 3). The corporate bond spread at over 400 bp now from 250 bp in June also suggests difficult credit conditions for corporates.

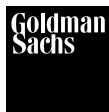
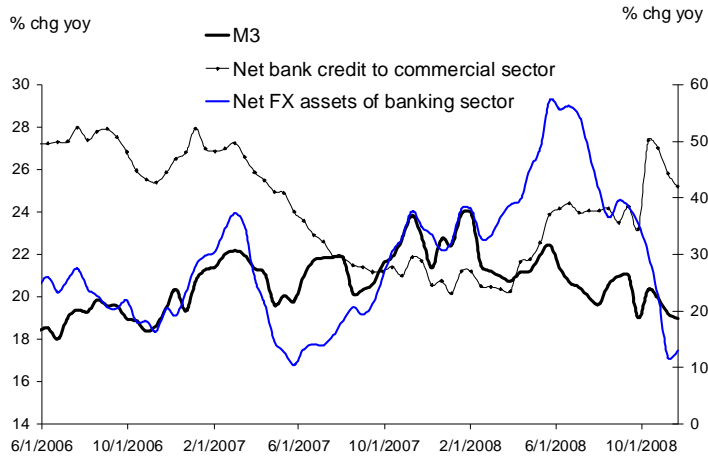
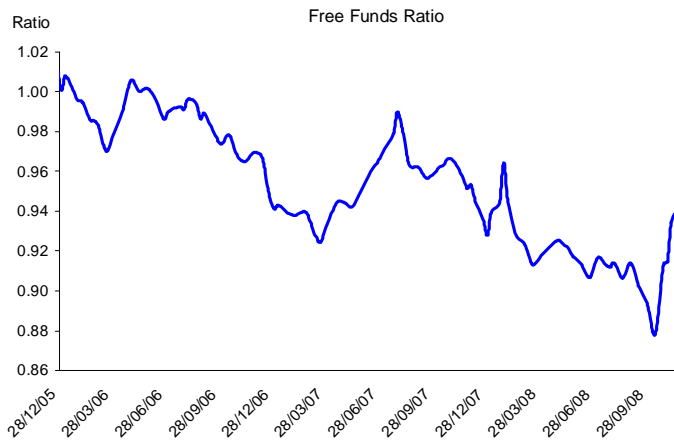


Exhibit 1: Broad money M3 growth continued to moderate



Source: RBI, CEIC, Goldman Sachs Economics Research.

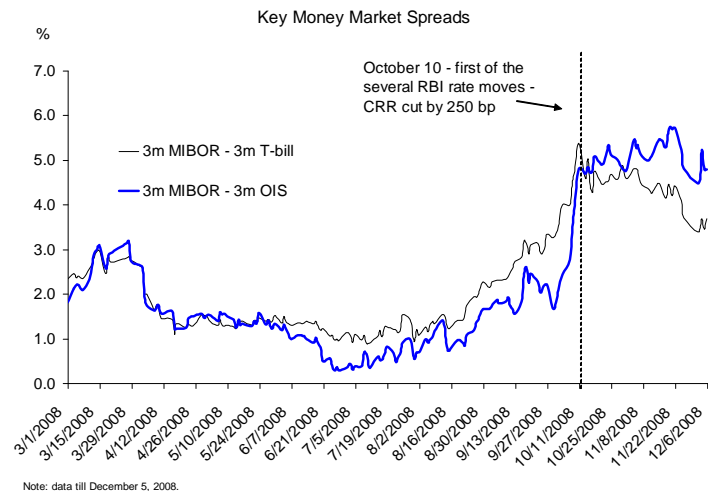
Exhibit 2: Free funds of banks are rising



Note: Free Funds ratio = $(1 - CRR - SLR) \times \text{bank's deposits/credit}$

Source: RBI, CEIC, Goldman Sachs Economics Research.

Exhibit 3: Credit spreads are still high...



Note: data till December 5, 2008.

Source: Bloomberg, Goldman Sachs Economics Research.

Copyright 2008 The Goldman Sachs Group, Inc. All rights reserved.

This material should not be construed as an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. We are not soliciting any action based on this material. It is for the general information of clients of The Goldman Sachs Group, Inc. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients. Before acting on any advice or recommendation in this material, clients should consider whether it is suitable for their particular circumstances and, if necessary, seek professional advice. The price and value of the investments referred to in this material and the income from them may go down as well as up, and investors may realize losses on any investments. Past performance is not a guide to future performance. Future returns are not guaranteed, and a loss of original capital may occur. The Goldman Sachs Group, Inc. does not provide tax advice to its clients, and all investors are strongly advised to consult with their tax advisers regarding any potential investment. Certain transactions - including those involving futures, options, and other derivatives as well as non-investment-grade securities - give rise to substantial risk and are not suitable for all investors. The material is based on information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied on as such. Opinions expressed are our current opinions as of the date appearing on this material only.

We endeavor to update on a reasonable basis the information discussed in this material, but regulatory, compliance, or other reasons may prevent us from doing so. We and our affiliates, officers, directors, and employees, including persons involved in the preparation or issuance of this material, may from time to time have "long" or "short" positions in, act as principal in, and buy or sell the securities or derivatives (including options) thereof of companies mentioned herein. For purposes of calculating whether The Goldman Sachs Group, Inc. beneficially owns or controls, including having the right to vote for directors, 1% of more of a class of the common equity security of the subject issuer of a research report, The Goldman Sachs Group, Inc. includes all derivatives that, by their terms, give a right to acquire the common equity security within 60 days through the conversion or exercise of a warrant, option, or other right but does not aggregate accounts managed by Goldman Sachs Asset Management. No part of this material may be (i) copied, photocopied, or duplicated in any form by any means or (ii) redistributed without The Goldman Sachs Group, Inc.'s prior written consent.

The Global Investment Research Division of Goldman Sachs produces and distributes research products for clients of Goldman Sachs, and pursuant to certain contractual arrangements, on a global basis. Analysts based in Goldman Sachs offices around the world produce equity research on industries and companies, and research on macroeconomics, currencies, commodities and portfolio strategy.

This research is disseminated in Australia by Goldman Sachs JBWere Pty Ltd (ABN 21 006 797 897) on behalf of Goldman Sachs; in Canada by Goldman Sachs Canada Inc. regarding Canadian equities and by Goldman Sachs & Co. (all other research); in Germany by Goldman Sachs & Co. oHG; in Hong Kong by Goldman Sachs (Asia) L.L.C.; in India by Goldman Sachs (India) Securities Private Ltd.; in Japan by Goldman Sachs Japan Co., Ltd, in the Republic of Korea by Goldman Sachs (Asia) L.L.C., Seoul Branch; in New Zealand by Goldman Sachs JBWere (NZ) Limited on behalf of Goldman Sachs; in Singapore by Goldman Sachs (Singapore) Pte. (Company Number: 198602165W); and in the United States of America by Goldman, Sachs & Co. Goldman Sachs International has approved this research in connection with its distribution in the United Kingdom and European Union. This material has been issued by The Goldman Sachs Group, Inc. and/or one of its affiliates and has been approved for the purposes of section 21 of the Financial Services and Markets Act 2000 by Goldman Sachs International, which is regulated by the Financial Services Authority, in connection with its distribution in the United Kingdom, and by Goldman Sachs Canada, in connection with its distribution in Canada. Goldman Sachs International and its non-US affiliates may, to the extent permitted under applicable law, have acted on or used this research, to the extent that it relates to non-US issuers, prior to or immediately following its publication. Foreign-currency-denominated securities are subject to fluctuations in exchange rates that could have an adverse effect on the value or price of, or income derived from, the investment. In addition, investors in securities such as ADRs, the values of which are influenced by foreign currencies, effectively assume currency risk. In addition, options involve risk and are not suitable for all investors. Please ensure that you have read and understood the current options disclosure document before entering into any options transactions.

Further information on any of the securities mentioned in this material may be obtained on request, and for this purpose, persons in Italy should contact Goldman Sachs S.I.M. S.p.A. in Milan or its London branch office at 133 Fleet Street; persons in Hong Kong should contact Goldman Sachs (Asia) L.L.C. at 2 Queen's Road Central; persons in Australia should contact Goldman Sachs JBWere Pty Ltd. (ABN 21 006 797 897), and persons in New Zealand should contact Goldman Sachs JBWere (NZ) Ltd. Persons who would be categorized as retail clients in the United Kingdom, as such term is defined in the rules of the Financial Services Authority, should read this material in conjunction with the last published reports on the companies mentioned herein and should refer to the risk warnings that have been sent to them by Goldman Sachs International. A copy of these risk warnings is available from the offices of Goldman Sachs International on request. A glossary of certain of the financial terms used in this material is also available on request. Derivatives research is not suitable for retail clients. Unless governing law permits otherwise, you must contact a Goldman Sachs entity in your home jurisdiction if you want to use our services in effecting a transaction in the securities mentioned in this material.