An Indian Summer: The Month That Was

- After making financial markets sweat it out, the inflation rate slowed down on the back of better Rabi winter crop and lower commodity prices. A sustained control over money supply will be necessary to continue the trend, especially in consumer prices.

- Industrial growth though still a high 13.6%, shows lower growth in mass consumption goods. We expect the growth to taper off into single digits by October 2007 if not sooner.

- As interest rates hardened, the Indian debt market swung into action. Equity offerings the first two months of FY08 are a mere 35% of the amount raised in the same period, a year ago, but many big issues are planned over the next two months.

- The unexpected strength in the Rupee thanks to higher inflows of US Dollars caught companies and traders with unhedged positions on the wrong foot. However we expect the Dollar to regain its strength over the next few months.

Annual change (%)	Jan-07	Feb-07	Mar-07	Apr-07	2-Yr Outlook	Point of view
CPI– Rural	9.5	9.8	9.5	9.2	Weak	Prices lower due to elections (June 09) and stable crude oil prices; Interest rates to head lower, benefiting interest rate sensitive sectors.
CPI – Urban	7.4	7.8	7.6	7.7	Weak	
WPI	6.6	6.1	6.3	5.6	Weak	
Gross fiscal deficit	20.8	2.7	48.5	-13.0	Neutral	A lower deficit will allow cheaper funds for investment activity in the private sector
Money supply, M3	21.1	21.8	22.0	21.0	Neutral	Adequate liquidity will be available to finance rapid growth
Resources raised from Capital mkts	-42.0	-37.4	-78.8	-82.0	Strong	As investment activity picks up, resources raised from the capital markets will grow; some companies will dilute equity to fund growth
IIP	11.4	11.0	14.5	13.6	Strong	Industrial growth will slow down as demand takes a hit due to higher interest rates in the short term; Fresh capacity kick in only in FY09
Railway freight traffic	6.5	6.8	8.9	4.5	Strong	The near term downtrend will reverse as economic activity picks up
Exports	5.5	7.9	8.8	23.1	Strong	Since we expect Rupee to depreciate against the US Dollar, exporters should benefit
Imports	23.2	25.1	14.5	40.7	Strong	Non-oil imports will increase on the back of growth in domestic consumption and investment activity; will act as a check on inflation
SBI lending rate (% pa)	11.5 to 12.0	12.3 to 12.5	12.3 to 12.5	12.3 to 12.5	Neutral / Weak	Interest rates are close to their peak (some upside left); As rates stabilise / head lower, interest rate sensitive sectors will benefit
Forex reserves (US$ bn)	180	195	199	204	Strong	As reserves increase, the RBI could make it even more easier for Indian companies and individuals to invest abroad
Rs/US $ - average	44.3	44.2	44.0	42.2	Strong	A gradual depreciation of Re by March 08, helping exporters
Rs/Euro - average	57.7	57.7	58.3	57.0	Strong	Euro strengthens over FY08 but loses steam later as growth peaks in Europe

Source: CSO, RBI

Economic Growth Spurs Stock Markets

Growth is wanted, pursued and has a premium attached to it. It increases incomes, raises standards of living and thus affects individuals in their daily life. It stops being a single number conjured up in ivory towers though with a base firmly rooted in a zillion bits of data. The one number we follow in India is the annual change in her Gross Domestic Product (with the prices of its constituents kept constant at 2000 levels so that we can negate the effects of price rises from the actual growth in incomes across a whole host of professions). The effects of growth in a low interest rate regime have company profits trebling in as many years. So it is no surprise that the stock markets were euphoric with the GDP growth rate staying afloat over 8.5% for the fourth year in the last five years. Today India is the second-fastest growing economy in the world after China. The moneyed world is interested in India as a destination for investments as the higher incomes in the hands of millions of Indians will translate into more demand for various products and services that spawns further phases of growth.

Growth was easier in some sectors

The current growth phase in India has seen incomes in hotels; communication, construction, and transport multiply faster than the other sectors. Better productivities in these sectors have seen returns outpacing investments. Traditional manufacturing has seen a more sedate growth while growth in mining and agriculture has been almost static. Manufacturing has been constrained by lack of physical infrastructure - logistics suffered due to bad transport systems and the complete derailment of the power process in the economy has raised the general level of costs. As and when the government either puts money where its mouth is or whenever it allows the private sector to invest in infrastructure, the productivity gains for Indian industry will be immense. And as internal accruals have been the main source of growth for the private sector, this will also help them fund their further expansions.

Sectors to watch out for

Among the services, financial services have seen some growth, and with some reform in the way of functioning, can see much more growth to keep pace with the increased speed of transactions within the growing economy (Here's our view on companies in the banking/finance sector. Click here.). Education as a sector is on the brink of great strides and healthcare too is yet to fruition its promise of growth. Agricultural investments have not been up to the mark and as a result the per capita availability of food grains is down to what it was in 1975! Buffeted as it is by inflation on one hand and the rise in unemployment, the government does not have much room to maneuver on this issue. We believe the time is ripe for another green revolution in India but one that is more socially acceptable and eco-friendly. This should also spur investments in storage and logistics to maximise returns.

To quantify the optimism on growth, if India invests what the Planning Commission estimates is required in mining, power and port development alone, its GDP can be raised by 5% to 7% in real terms annually for the next five years.

Over the next few quarters

Be ready to see some deceleration in the Index of Industrial Production and to some extent the GDP growth itself. Inflationary tendencies are being resolutely tackled by the central bank. The last few weeks have shown the inflation numbers tapering off. Any more surprises on that front (quite unlikely we feel) could trigger some more pressure on interest rates that should slow down not only profitability but also growth per se. Something both the political leaders as well as the RBI do not want to precipitate.

The risks involved in the process

Other than the monetary phenomena, further growth in India's GDP can be challenged by the various fissures that seem to have opened up. Contrary to the much-hyped pool of scientifically trained manpower, most firms are constrained more by its lack. Procedural delays in India for getting the 'Okay' for new projects probably are amongst the worst in the world. India's need for fresh capital is far more than what her savings can fulfill and if foreign capital has to be enticed into investing, these matters have to be ironed out to seem equitable. A whole new slew of reforms are required for keep India in her current 9%+ bracket of sustained growth. Over the next few months do look out for our 'eco select' as we delve into each of these dark clouds and try and see the silver lining!!

How should all this impact your investment strategy? Click here to read our Investment Ideas note.

India: Sectors that lead… and those that lag

GDP growth patterns (at 2000 prices)	Weight	FY06	FY07	FY08e	FY09e
Agriculture & Mining	20.5	5.8	2.9	3.4	3.3
Manufacturing & Power	17.6	8.6	11.7	7.6	8.3
Services	61.9	10.3	11.0	9.5	9.8
Construction	6.8	14.2	10.7	10.0	9.0
Trade and Hotels	16.0	8.2	12.0	11.0	12.0
Transport and Communication	11.1	13.9	14.4	12.5	12.0
Financial Services and Real Estate	14.0	10.9	10.6	8.0	9.5
Community Services	14.1	7.7	7.8	6.5	6.0
GDP at factor cost	**100.0**	**9.0**	**9.4**	**7.9**	**8.3**

Source: CSO, equitymaster

World: Takes a Breather…

The World Bank estimates that the global average growth rate will reduce over 2007-2009 as Chinese and Indian economies slow down. Thankfully the transition will be smooth.

Real GDP Growth	2005	2006E	2007F	2008F	2009F
World	3.5	4	3.3	3.6	3.5
High Income	**2.6**	**3.1**	**2.4**	**2.8**	**2.8**
United States	3.2	3.3	1.9	3.0	3.1
Euro Area	1.3	2.7	2.5	2.2	2.0
Japan	2.6	2.2	2.3	2.4	2.1
Developing Countries	**6.7**	**7.3**	**6.7**	**6.2**	**6.1**
China	10.2	10.7	9.6	8.7	8.5
Russia	6.4	6.7	6.3	5.6	5.8
Brazil	2.9	3.7	4.2	4.1	3.9

Source: World Bank. GDP at 2000 prices and constant dollars

Last week's stronger employment numbers for the United States are in line with the World Bank's estimates of a US recovery in the second half of 2007. US housing demand is expected to recover going forward into 2008 and 2009, and along with lower stocks, it should fuel growth. Though lower crude prices are expected to reduce the inflationary pressures within the US, interest rates are expected to continue their upward trend thanks to higher demand. In the European Union (EU), still-strong order books coupled with a higher production are expected to translate into increased consumer demand that will fuel further growth in 2007. The inclusion of new member states into the EU too is expected to improve export performance. Over the next two years, however, greater inflationary pressures will see renewed vigour on the interest rate front that can reduce the growth to more sustainable levels.

Even as we expect India to slow down, China's huge current account surplus would force a moderate currency appreciation that could reduce US demand for Chinese goods, also its domestic inflation would see brakes being applied to further growth. For the developing economies, a slower import demand from high-income countries, weakening of commodity revenues with most price cycles peaking, capacity constraints, and an expected increase in interest rates in response to rising inflation in some countries are expected to ease the pace of growth through 2009. As a group, however, low- and middle-income countries should continue to outperform high-income economies by a wide margin. Their strong performance will continue to be a critical driver of global growth.