



INDIA

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Table of Contents

Spotlight	1
Market in Pictures	2-3
India Mkt Monitor +	
Financial Mkt Forecasts	4

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CitiViews – India Market Watch

➤ **Spotlight on Indo-Japan relations:** Despite last week’s domestic political turmoil, PM’s Shinzo Abe’s first visit to India was a fruitful one. With Indo-Japan trade currently at US\$6.5bn, the visit culminated with the proposal to increase bilateral trade to US\$20bn in three years thus aiming to reduce the dependence on China. In addition, to the currency swap agreement, both sides made headway on several key issues that will be beneficial to India, including:

- 1. Infrastructure:** Perhaps the biggest gain from PM Abe’s visit has been some break-through in financing the dedicated Rail Freight Corridor¹, where work on the Delhi-Mumbai and Delhi-Kolkata is expected to commence shortly. The Japan International Cooperation Agency has agreed to partly finance the project by way of a soft loan. Another infrastructure initiative is the Delhi-Mumbai Industrial Corridor (DMIC)², which will involve the development of infrastructure along the 1,483-km freight corridor. While the DMIC project cost is estimated at US\$100bn, the Japanese government and corporates are expected to provide close to US\$30bn in loans and investments towards the initiative that will eventually enable Japanese companies to make India a hub for exports to Europe.
- 2. Corporate Interest:** With PM Abe accompanied by over 160 business leaders from Japan, the visit has also had important ramifications for the corporate world. Several Japanese companies, including Toyota, Mitsubishi, Hitachi, and Canon, are now looking at India as a global manufacturing hub. In light of ongoing negotiations for an Indo-US nuclear deal, corporates such as Hitachi are also seeking opportunities to supply nuclear energy to India.
- 3. Bilateral Trade and Currency Swap Agreement:** Indo-Japanese bi-lateral trade is currently US\$6.5bn. With negotiations to sign a Comprehensive Economic Partnership Agreement (CEPA) at an advanced stage, and scheduled for completion by 2008; the Japanese PM hopes that bilateral trade will touch US\$20bn in 3 years. The CEPA could also result in more Japanese FDI which was barely US\$2.2bn (or 4% of total FDI into India) during 1991 through 2006. Other outcomes of PM Abe’s visit include a currency swap³ arrangement, whereby the two countries would provide emergency financial liquidity to each other in times of crisis.

¹ **The dedicated freight corridor** aims at linking Delhi, Kolkata, Chennai and Mumbai, and is perhaps the largest PPP initiative for the railways sector. The project, which involves building 9,380km of track at an estimated cost of Rs660bn, is due for completion within 5-7 years. The first phase consists of linking ports of the east (Kolkata) and west (JNPT-Mumbai) to Delhi and Punjab. This phase involves building 2,700km at an estimated cost of over Rs220bn.

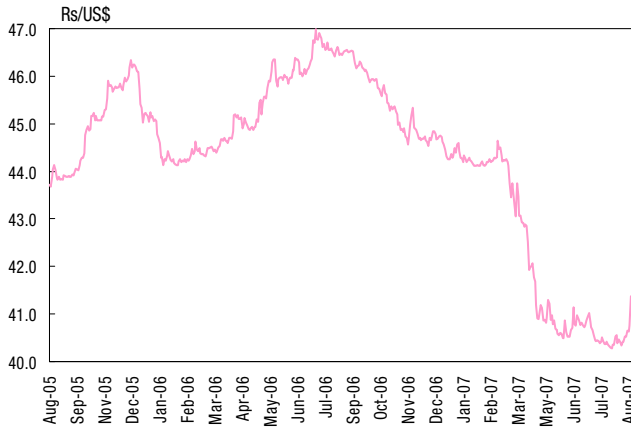
² **The Delhi-Mumbai industrial corridor** is a 1,483-kilometer industrial corridor through the northern states of Delhi, Uttar Pradesh, Haryana, Rajasthan, Gujarat and Maharashtra and is likely to comprise of six 200-square-kilometer investment regions dedicated to industries like chemicals and engineering, three ports, and six airports. While the total project cost is estimated at US\$100bn, the Japanese government and corporates are expected to provide close to US\$30bn in loans and investments towards the initiative. While the first phase of the project is due for completion by 2012, the second phase will span from 2012-16

³ **Currency swap** - Under this arrangement, Japan will accept rupees and give dollars, while India will accept yen and offer dollars, upto a prescribed limit, should a crisis situation arise. Apart from indicating Japanese confidence in the Indian economy; the currency swap would give India the opportunity to enter the existent currency swap arrangement which Japan has with 7 other countries, including China, Malaysia, Korea, and Singapore. This arrangement normally acts as a deterrent to currency speculation



India - Markets in Pictures

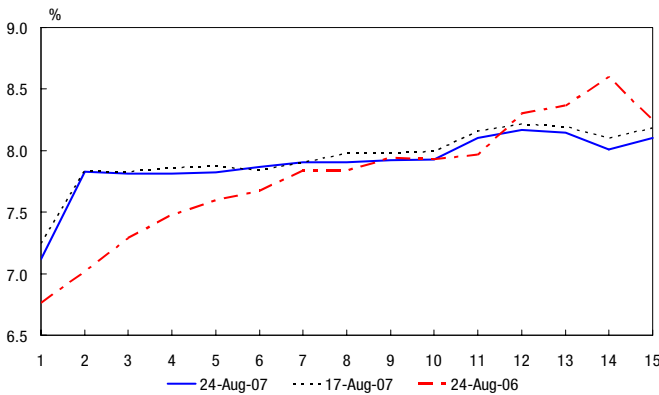
Trends in Exchange Rate - Rs/US\$



Rupee - The Week in Review

- The rupee closed the week at Rs41.10/US\$ from Rs41.32/US\$ in the previous week. Intra-week, the rupee traded at 40.79 – a result of a slight improvement in global sentiment, but it failed to sustain the sub Rs41/US\$ gains as domestic political concerns overshadowed the easing pressure on stock markets.
- Movements in the rupee are likely to remain choppy in the near term with trading likely to be influenced by global cues and domestic political developments. The long term INR appreciation story stands and we maintain our March08 estimate of Rs40/US\$

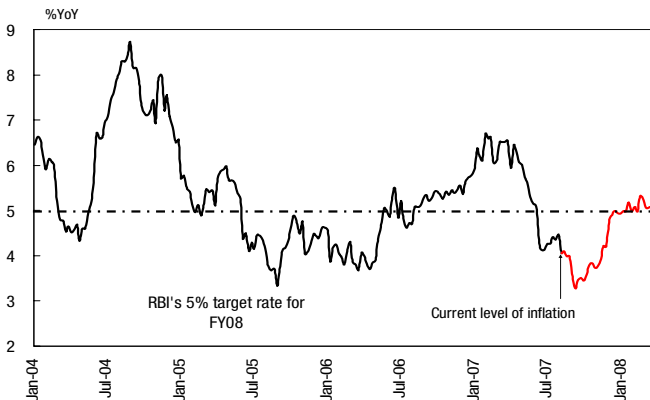
Trends in GOI Yield Curve



Bonds - The Week in Review

- Bond yields came off marginally with the 10-year yield easing to 7.93% from 8%
- Despite bond auctions, liquidity conditions remained comfortable with the RBI receiving Rs131bn on a daily average basis at the LAF window
- While the domestic political turmoil put some pressure on bonds, it was largely offset by lower crude prices and benign inflation

Trends in Inflation (% YoY)



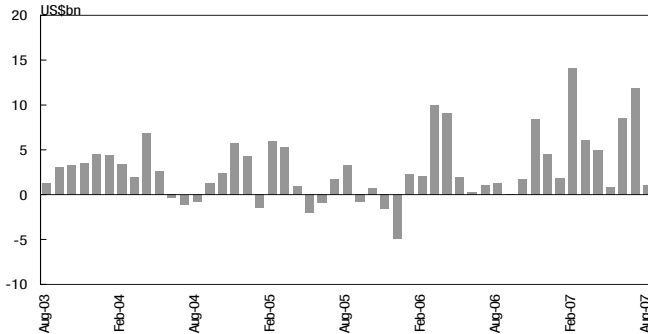
Tracking Inflation - Trends in the Wholesale Price Index

- Inflation came in at 4.13% for the week ended 11th Aug 2007. The ministry revised data for the week ended 16th June from 4.03% to 4.13%
- While growth in Primary Articles was up 6.36%yoy, the Index for Manf Products rose by 5.42% and the Fuel Index contracted by 1.3%
- Looking ahead, we expect inflation to remain at sub-5% levels over the coming months

Source: Reuters, Bloomberg

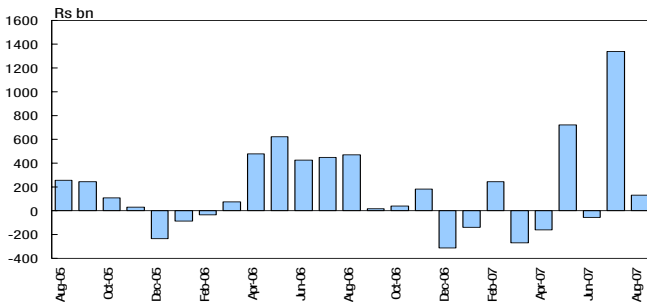
India – Markets in Pictures

Monthly Increase in Forex Reserves (US\$bn)



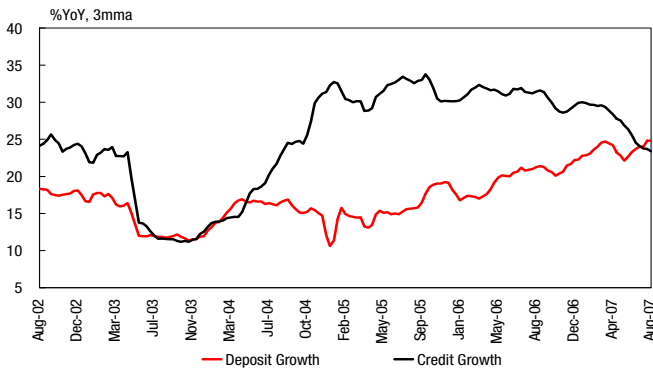
Largely due to revaluation, total forex reserves, including gold, declined by US\$2.5bn for the week ended 17th Aug. Fiscal YTD, foreign currency assets are up US\$27bn and currently stand at US\$219bn. Forex reserves including gold stand at US\$226bn.

Trends in Reverse Repos/Repos (Rs bn)



Average bids for reverse repos dropped to Rs131bn from Rs129bn but conditions were surplus to absorb auction outflows. Apart from the auctions, we believe that continued FII selling would also impact liquidity conditions

Trends in Bank Credit and Deposits (%)



The momentum in deposits which overtook loan growth two months ago continues with loan growth at 23.4% and deposits at 24.3%. This bodes well for the liquidity and rate environment.

Source: Reuters; Bloomberg; Citigroup

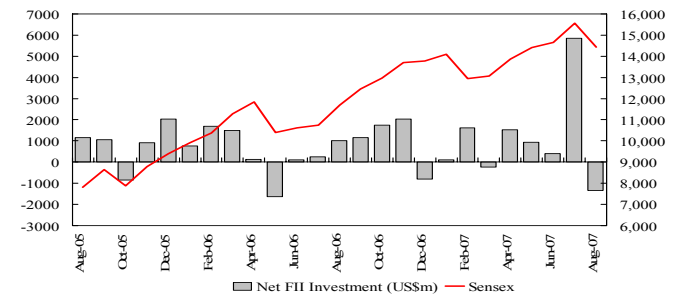
Monsoons: Cumulative Rainfall from 1 June-22 Aug: 3% Above Normal

(subdivisions)	Cumulative Rainfall from June 1 to					
	21Aug02	20-Aug03	25-Aug-04	24Aug05	23Aug06	22-Aug-07
Excess	1	7	1	5	7	12
Normal	15	25	27	23	17	17
Total	16	32	28	28	24	29
Deficient	17	4	8	8	12	7
Scanty	3	0	0	0	0	0
No rain	0	0	0	0	0	0
Total	20	4	8	8	12	7
TOTAL	36	36	36	36	36	36

Data released by the IMD indicates that while rainfall during for the week ended 22nd Aug was **35% below normal**, on a cumulative basis, rainfall from 1Jun- 22nd Aug was just **3% above normal**. To see the regional distribution of cumulative rainfall please click for map:

<http://www.imd.ernet.in/section/hydro/img/seasonal-rain.jpg>

2 Yrs - Trends in FII Flows (US\$ m)



Equities saw FII outflows to the tune of US\$865mn for the trading week ended 24th August. August MTD, outflows totaled US\$1.4bn as compared with inflows of US\$810m during the same period last year. Fiscal YTD, flows totaled US\$7.4bn as compared with outflows of US\$344mn during the same period last year.

Trends in Commodities – Oil (US\$/bbl)



Brent ended nearly flat at US\$69.98/bbl from US\$70.29/bbl. Selling in the first half of the week – a result of an increase in US crude stocks coupled with the weakening of Hurricane Dean was replaced by gradual buying interest spurred by US refinery problems



India- Market Monitor

	Units	Latest	Previous	1M ago	3M ago	12M ago
Interest Rates						
Overnight	%	6.40	15.00	0.30	7.80	6.10
1 year Treasury Bill	%	7.49	7.247	6.58	7.80	6.96
1 year OIS	%	7.48	7.56	6.68	8.09	6.67
1 year MIFOR	%	7.02	7.26	6.78	9.39	6.91
5 year Corp AAA spread over GOI	%	1.57	1.45	1.41	1.72	0.95
10 year GOI	%	7.93	7.99	7.77	8.15	7.93
Currency & Reserves						
USD/INR		41.10	41.32	40.28	40.60	46.53
EUR/USD		1.36	1.34	1.38	1.34	1.28
USD/JPY		115.84	113.31	120.79	121.38	116.32
12 Month INR Forward Premium	%	1.62	1.95	1.40	2.48	1.30
FX Assets As On (17 Aug 07)	US\$ bn.	219.1	221.6	222.0	203.9	158.0
Money & Banking						
Credit-Deposit Ratio	%	69.7	69.2	70.5	71.6	70.3
Money Supply - M3	% YoY	21.7	21.7	21.60	20.20	19.10
Inflation - WPI (11 Aug 07)	% YoY	4.1	4.05	4.41	5.62	6.73

Source: Citi; RBI.

Financial Market Forecasts

Currency Forecasts and Forwards

	Spot		3 Months		6 Months		12 Months	
	Range in Jul	23-Aug	Forecast	Forward	Forecast	Forward	Forecast	Forward
Versus USD								
Japan YEN	118.36 - 123.43	115.89	106.65	114.57	106.78	113.41	110.00	111.37
Euro EUR	1.36 - 1.38	1.3550	1.3776	1.3578	1.4078	1.3595	1.4200	1.3615
India INR	40.13 - 40.44	40.81	40.70	40.99	40.20	41.13	39.50	41.47
China RMB	7.56 - 7.61	7.5840	7.3800	7.4995	7.2000	7.3995	7.0000	7.1990

Source: Reuters, Citi estimates.

Interest Rate Forecasts

		Range in July	23-Aug	3Q07	4Q07	1Q08	2Q08
US	Fed Fund Rate	5.25 - 5.25	5.25	5.00	4.50	4.50	4.50
	10-Year Treasuries	4.73 - 5.18	4.69	4.75	4.75	4.80	4.90
EU	Repo Rate	4 - 4	4.00	4.00	4.00	4.00	4.00
	10-Year Bunds	4.30 - 4.67	4.30	4.25	4.30	4.40	4.60
JP	Call Money	0.48 - 0.535	0.47	0.50	0.50	0.75	0.75
	10-Year JGBs	1.79 - 1.96	1.60	1.75	1.70	1.80	1.90
IN	Overnight Repo Rate	7.75 - 7.75	7.75	7.75	7.75	7.75	7.50
	Overnight Reverse Repo Rate	6 - 6	6.00	6.00	6.00	6.00	6.00
	91-Day T Bill	4.46 - 6.19	6.81	6.50	6.50	6.50	6.50
	10-Year Gilt	7.73 - 8.1	7.93	8.00	8.00	7.50	7.50
CN	1-year lending rate	6.57 - 6.84	7.02	7.02	7.38	7.56	7.56
	7-Day Shibor*	2.05 - 4.05	2.23	3.30	3.10	3.40	3.60
	Government bond yield (5 -Year)	3.75 - 3.89	3.71	3.65	3.70	3.85	4.00

Bloomberg, Moneyline Telerate, Citi estimates.

Disclosure Appendix

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