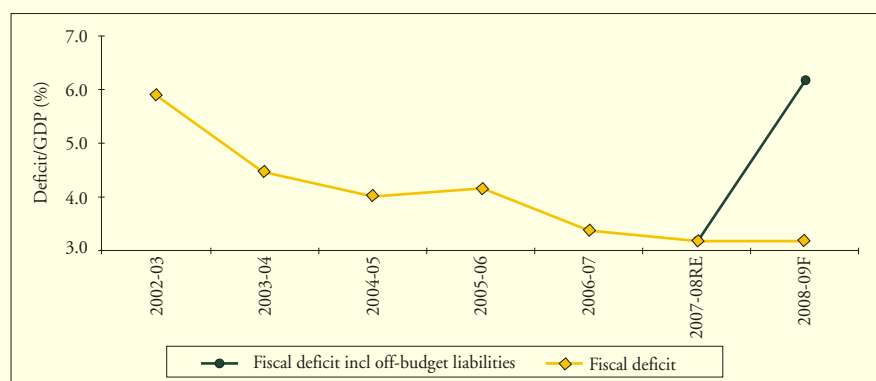
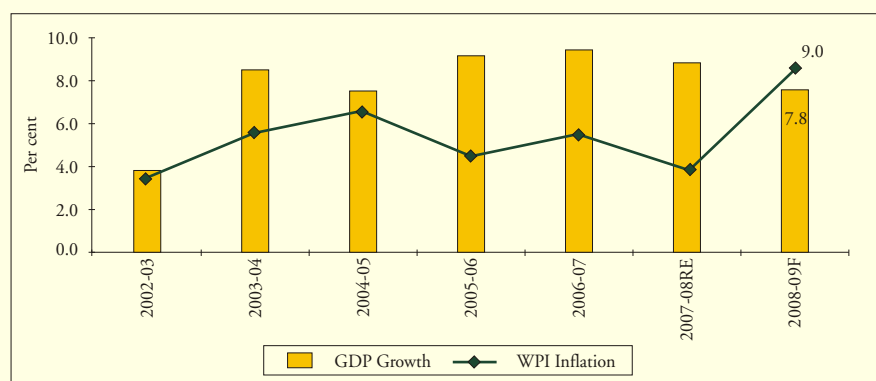


Eco insights

View of the Month : Economy under Stress

A sharp surge in global crude prices and the worsening domestic inflation scenario has dampened India's economic prospects. The fiscal cost of artificially suppressing domestic prices of petroleum products became unbearable with oil surging past US\$ 130 per barrel. This led to an upward revision in the domestic prices of petrol, diesel and LPG. Although retail prices have been increased only marginally compared to other economies, the price rise brought suppressed inflation out into the open. As inflation continues to surge way above the comfort zone, the monetary policy has been tightened further in recent weeks. Further tightening is likely as the inflationary pressures are expected to continue going forward.

We expect a moderate growth deceleration from our earlier forecast of 8.1 to 7.8 per cent in FY09. The major changes are in the inflation and fiscal outlook. Barring exceptional turnaround in international commodity prices, our forecast for inflation is now in the range of 8.5 - 9.0 per cent. The reluctance to pass on price increases of petroleum products and fertilizers, not to mention commitments such as the farm loan waiver and the Pay Commission recommendations will take the central government's fiscal deficit to 6.2 per cent of GDP (including the off-budget liabilities in the form of oil and fertilizer bonds). There is a bit of offset from higher tax revenues resulting from higher than expected nominal GDP growth, but that will hardly compensate for mounting liabilities. The rupee is expected to trade at 41-41.5 to the US\$ by March 2009 as we expect the foreign inflows to pick up towards the end of the year.



Source: CRISIL Estimates

Outlook Financial Year 2008-09

	Parameter	Forecast
Growth (%)	Agriculture	3.0
	Industry	7.5
	Services	9.5
	Total GDP	7.8
	Private Consumption	7.6
Inflation	WPI Average	8.5 - 9.0
Interest rate	10-year G-Sec (Year-end)	8.5 - 8.7
Exchange rate	Re / US\$ (Year-end)	41.0- 41.5
Fiscal deficit	as a % of GDP	6.2

Source: CRISIL

Indian Economy: Performance and Outlook

Balance of Payments

Surging oil imports bloat the current account deficit for 4Q08

- Current account deficit (CAD) stood at US\$ 1.04 billion in 4Q08, compared with a surplus of US\$ 4.3 billion in the same period last year. With this, the CAD for FY08 widened to US\$ 17.4 billion from US\$ 9.8 billion in FY07.
- Merchandise exports posted a higher growth of 20 per cent (y-o-y) in 4Q08, whereas a staggering increase of 88 per cent in the oil imports pushed up the import payments to 37.2 per cent. This resulted in a wider trade deficit of US\$ 23.8 billion in 4Q08 and US\$ 90.1 billion for the entire year.
- Capital account surplus narrowed to US\$ 25.4 billion in the last quarter of FY08 & it stood at US\$ 109.57 billion for FY08.
- Overall, BoP surplus stood at US\$ 24.9 billion in the 4Q08, taking the full year total to US\$ 92.15 billion. We expect CAD to be around 2.6 per cent of GDP in FY09.

Industry

Manufacturing sector slows down; capital goods in recovery mode

- Industry expanded by 7 per cent in April compared to an abysmal 3.9 per cent in March. Manufacturing sector slowed down to 7.5 per cent, while mining sector grew at a healthy rate of 8.6 per cent in April.
- Capital goods sector growth bounced back to clock 14.2 per cent growth in April compared to the lows it had registered in last few months.
- After recording negative growth eight times in the past 16 months, consumer durables posted 5.5 per cent growth in April.
- Going forward, the recent rate hikes announced by the RBI are expected to slow down industrial growth as the borrowing costs escalate. We expect overall industrial growth at 7.5 per cent in 2008-09.

Inflation

Inflation crosses the 11 per cent mark in the first half of June, averages over 8 per cent in May

- Headline inflation for May reached 8.3 per cent compared to 7.6 per cent recorded last year. It however, breached the double-digit mark and posted a 13-year high 11.47 per cent for the week ended June 14.
- Primary articles group clocked a y-o-y growth of 9.26 per cent in May, with food articles growing by 5.5 per cent.
- Inflation in manufactured products rose by 8.12 per cent whereas fuel group rose by 7.68 per cent in May.
- Following the WPI index, the CPI-IW has also started inching up in recent months. For April it clocked 7.81 per cent compared with 7.87 per cent in March.
- Average inflation for 2008-09 is expected to be in the range of 8.5-9.0 per cent, significantly above the RBI's comfort levels.

Interest rate

Yield on 10-year G-secs at 7 year high after the rate hike

- Yield on the 10-year G-sec reached its 7-year high of 8.60 per cent on June 16, after the inflation for the week ending June 6 came at 13-year high of 11.05 per cent.
- Liquidity tightened towards the latter part of June with the outflow of advance tax payments. It is expected to remain tight going forward as well, due the hike in CRR and repo rate.
- Upward pressure on 10 year G-sec is expected to intensify in the near-term, with the possibility of further interest rates hike in addition to the 50 bps increase in repo rate and CRR announced on June 24.
- Yield on the benchmark 10-year G-sec is expected to remain in the range of 8.5-8.7 per cent by the end of 2008-09.

Rupee

Rupee depreciates due to FII outflows

- Rupee continued to depreciate sharply against the US dollar in June, ending June 27 at 42.88. This amounts to 4.55 per cent depreciation on a y-o-y basis.
- Net FII outflows worth US\$ 5.2 billion since the beginning of the calendar year coupled with increase demand of dollars by the oil companies was behind the weakening of the INR vis-à-vis US dollar.
- Subdued FII inflows in near future along with the increase in dollar demand by the oil companies is likely to add to the pressure on the rupee to depreciate in the near term.
- Upward pressures on the currency emanate from a cheap stock market, interest rate hikes and relatively good medium term economic outlook for the economy.
- On balance, rupee is now expected to trade at around 41.0-41.5 to the dollar by the end of 2008-09. This is premised on the assumption that US economy will show some recovery towards the end of the year which will improve risk appetite and hence resumption of FII inflows.

Trade

Trade deficit at record high in May

- Exports (in dollar terms) slowed down to a 14-month low of 12.9 per cent in May, compared to 31.5 per cent recorded in April.
- Imports growth (in dollar terms) remained high at 27.1 per cent in May, with the key driver to this increase being the continuous strong growth in oil imports at 50.8 per cent in May.
- Monthly trade deficit widened to a record US\$ 10.8 billion in May from a US\$ 9.9 billion in April, a growth of 51.6 per cent (y-o-y).
- We expect the exports to grow at 19 per cent and imports to grow at 28.2 per cent in FY09.

Global Developments

- **US:** Growth in first quarter of 2008 was marginally revised upwards to 1.0 per cent (q-o-q) from 0.9 per cent reported earlier. Led by the rise in food and oil prices, inflation in May surged at 4.2 per cent.
 - ◆ Exports rebounded to 19.2 per cent in April but high oil prices pushed up the import bill 13.5 per cent higher.
 - ◆ As expected, the Fed choose to leave the fed rate and discount rate unchanged at 2 per cent and 2.25 per cent respectively in its June 25 meeting. The accompanying statement was less hawkish than what analysts had expected.
- **UK:** 1Q08 GDP growth was revised marginally downwards to 2.3 per cent from 2.5 per cent reported earlier. Inflation in May shot up to 3.3 per cent owing to sharp rise in food and oil prices.
 - ◆ Bank of England (BoE) kept the interest rates unchanged at 5 per cent in its June meeting, after easing them by 25 bps in April to encourage growth.
- **Euro area:** Led by strong growth in Germany, Euro area expanded by a higher than expected 2.2 per cent in the 1Q08. Headline inflation in May clocked 3.7 per cent from 3.3 per cent in April.
 - ◆ European Central Bank (ECB) increased its key policy rate by 25 bps to 4.25 per cent in its July meeting to rein in the inflationary pressures in the economy.
- **Japan:** Economic growth during first quarter of 2008 was revised marginally upwards to 1.3 per cent from 1 per cent reported earlier. Headline inflation rate surged to a decade high of 1.3 per cent in May, driven by surging energy and food prices.
 - ◆ The Bank of Japan's quarterly survey, 'Tankan' for large manufacturers slipped for a third consecutive quarter, to near 5-year low of +5 for the 2Q08.
- **China:** Economy continued to witness rapid growth owing to buoyant domestic investment, rising consumption and healthy exports. GDP expanded by a healthy 10.6 per cent in the 1Q08.
 - ◆ After 3 consecutive months of above 8 per cent headline inflation, prices decelerated at 7.7 per cent in May helped by falling food prices.
 - ◆ To cease excessive liquidity pressures, the Central Bank raised the CRR for the thirteenth consecutive time by a more aggressive 100 bps to 17.5 per cent.

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Data Summary

	Jan-08	Feb-08	Mar-08	Apr-08	May-08	Jun-08
Industrial Production*						
- General	6.18	8.64	3.94	7.02	-	-
- Manufacturing	6.72	8.64	3.90	7.45	-	-
- Mining	2.87	7.58	4.89	8.56	-	-
- Electricity	3.66	9.77	3.65	1.39	-	-
- Basic Goods	3.57	7.30	3.36	4.61	-	-
- Capital Goods	2.63	10.39	11.00	14.22	-	-
- Intermediate Goods	7.98	7.95	4.32	4.21	-	-
- Consumer goods	8.37	9.65	0.90	8.90	-	-
- Consumer Durables	-0.54	2.99	-1.75	5.50	-	-
- Consumer Non-Durables	11.07	11.75	1.77	9.85	-	-
Inflation*						
- WPI-Primary Articles	4.86	8.00	10.08	8.85	9.26	10.87**
- WPI-Manufactured Products	4.51	4.84	7.48	7.80	8.12	9.42**
- WPI-Fuel, Power L&L	3.85	5.41	6.83	7.13	7.68	16.31**
- WPI-All Commodities	4.45	5.67	7.89	7.91	8.28	11.23**
CPI-Industrial Workers	5.51	5.47	7.87	7.81	7.75	-
Exports US\$*	20.47	35.25	25.38	31.47	12.87	-
Imports US\$*	63.57	30.53	34.82	36.61	27.11	-
FOREX Reserves#	282.80	294.44	305.94	312.66	314.01	312.94
Markets##						
BSE SENSEX	19325.65	17727.54	15838.38	16290.99	16945.65	14997.28
CNX-NIFTY	5756.35	5201.56	4769.50	4901.91	5028.66	4463.79
P/E	25.53	22.23	20.18	20.71	20.66	18.22
Exchange Rate						
INR/US\$	39.37	39.73	40.36	40.03	42.13	42.82
INR/GBP	77.54	78.04	80.86	79.25	65.53	66.61
INR/ 100 YEN	36.45	37.08	40.09	38.93	82.76	84.13
INR/EURO	57.92	58.59	62.64	63.00	40.41	40.05
INR/Yuan	5.42	5.54	5.68	5.71	6.03	6.20
Interest Rate						
PLR (Per cent)	12.75-13.25	12.6-13.2	12.25-12.75	12.25-12.75	12.25-12.75	12.25-12.75
1 Year GoI Paper (Per cent)	7.44	7.47	7.51	7.71	-	8.24
10 Year GoI Paper (Per cent)	7.57	7.53	7.66	8.04	-	8.36

*Growth year-on-year

** Inflation till June 14

US Billion Dollars

Index Value

Source: RBI, GoI, BSE

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