GLOBAL OUTLOOK 2009

Surviving the Chill

ICICI Bank
Corporate Solutions

Country Outlook

United States
Severe recession in the offing amidst a negative feedback loop from turbulent financial markets; Dollar to weaken substantially in H2-09

Euro-zone
The first ever EZ recession could turn out to be rather ugly. With inflation risks balanced, ECB to go down further. Euro to rise against majors

United Kingdom
High odds of a severe recession, amidst deflationary risks, presage more monetary easing. Sterling to forge subdued gains

Japan
Recessionary risks abound, raising specter of deflation. BoJ poised for an extended pause; Yen to nudge up gradually as uncertainty abates

Switzerland
Activity to come to a halt as financial strains persist and global downturn accelerates.. Expansive policy to keep CHF under pressure vs. EUR

China
Grinding to a halt, despite Government pulling out all stops. Reversal in Yuan policy expected next year.

India
Pervasive slowdown in growth and ebbing inflation to pull down rates. Dollar drift to support Rupee but fundamentals remain weak

US

Economic headwinds + Credit crisis = Severe recession

Rising joblessness to feed the ongoing pullback in spending

Ongoing crunch to weigh heavily on cash-strapped consumer

Deteriorating growth outlook increases deflationary risks

Prospects of housing recovery extremely dim amidst strong headwinds

Plethora of event risks dominate US credit outlook in 2009

USD faces substantial downside risks as policy moves into unchartered territory

Economic headwinds + Credit crisis = Severe recession

Negative feedback loop from worsening financial markets…

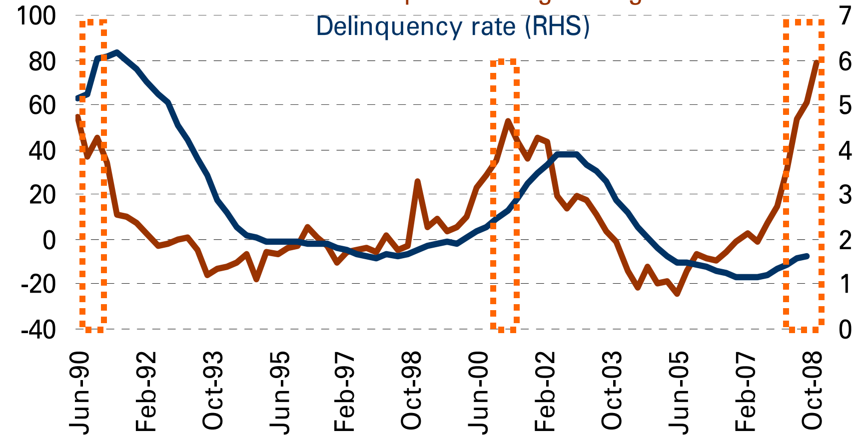
Key Domestic Indicators

Recession Economy	Current Level	3 Month Avg	Avg during past recessions	Min value in Current Cycle	Avg min value in Past recessions
ISM	36.2	39.53	43.80	36.2	35.8
NFP (Change)	-533	-418	-122	-533	-602
Retail Sales (% MoM)	-1.8	-2.10	0.34	-2.9	-2.7
Industrial Production (% MoM)	1.3	-1.20	-0.52	-3.7	-1.96
New House Price (%YoY)	-11.52	-8.71	-0.04	-12.68	-6.92
Consumer Confidence	44.9	48.37	76.23	38.8	61.8
Corporate Profits (% peak to trough decline)*	-5.73	-	-6.89	-	-
Dow (% decline from peak)	-35.76	-28.60	-	-35.76	-19.05

* 1980-81 recession has been left out (profits had then slumped 113%.)

…along with tightening credit standards…

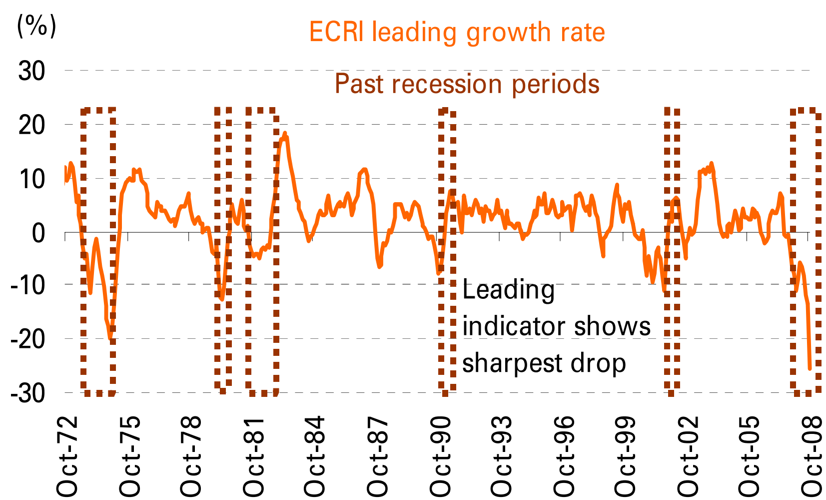
Commercial & Industrial loans



Box represents recession period

Source:Reuters Ecowin, ICICI Bank Research

… have heightened expectations of a deep and prolonged recession



Box represents recession period

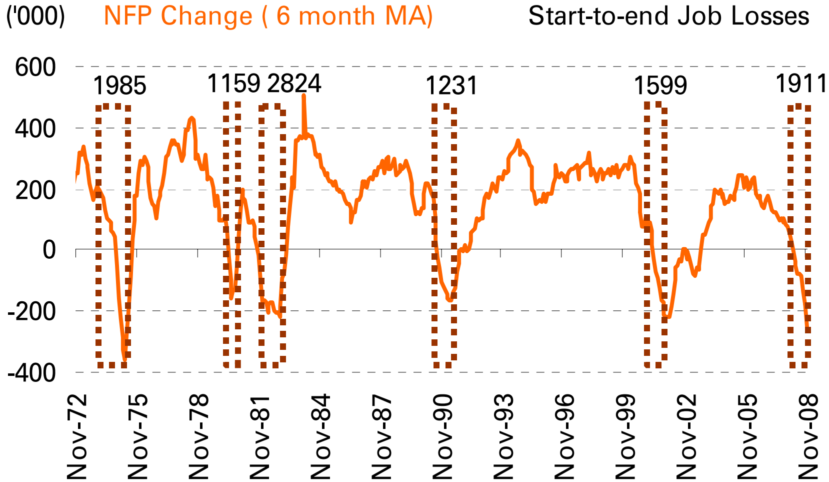
Source: Bloomberg, ICICI Bank Research

Gearing up for the long haul as revival seems farfetched

- As key economic indicators breach past recession troughs and the US housing and credit crisis continues to unfold, we expect the ongoing growth contraction to continue throughout 2009.
- As per the Business Roundtable Survey, U.S CEO confidence in the economy has plunged to a historical low level with majority planning to cut jobs and capital spending, as they face spreading global recession.
- While a revival seems farfetched, the effectiveness of recent as well as potential initiatives to stabilize financial markets, the response of US households to fiscal measures, and the depth of housing cycle, will play an important role in stabilizing the economy over the longer term.

Rising joblessness to feed the ongoing pullback in spending

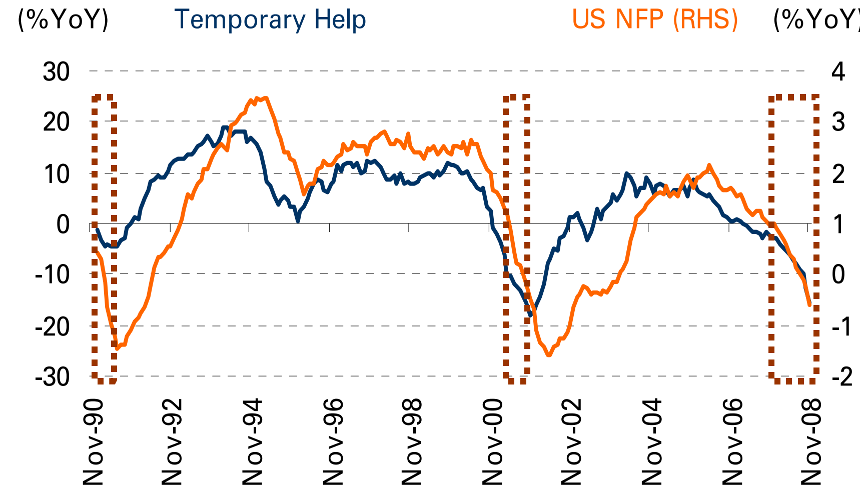
Steepest job losses since 1981-82 recession



Box represents recession period

Source: Bloomberg, ICICI Bank Research

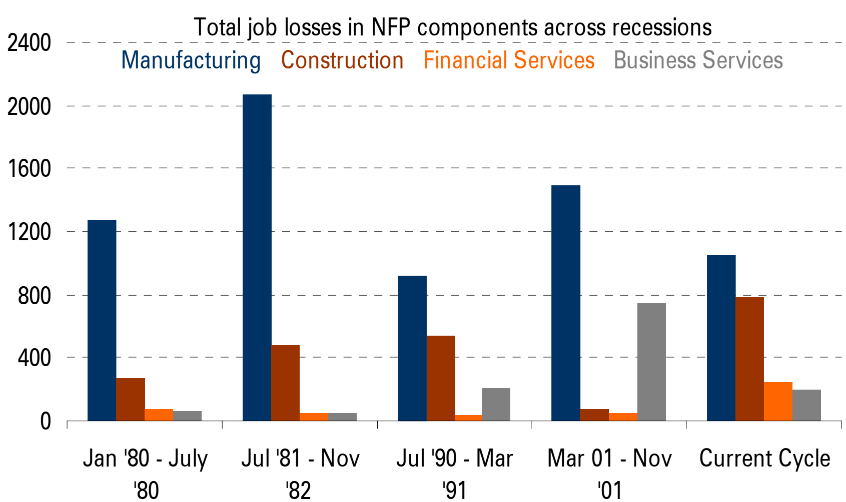
Ongoing losses in temporary jobs point to further labor market weakening



Box represents recession period

Source: Bloomberg, ICICI Bank Research

Expect further job losses in manufacturing sector as economy worsens



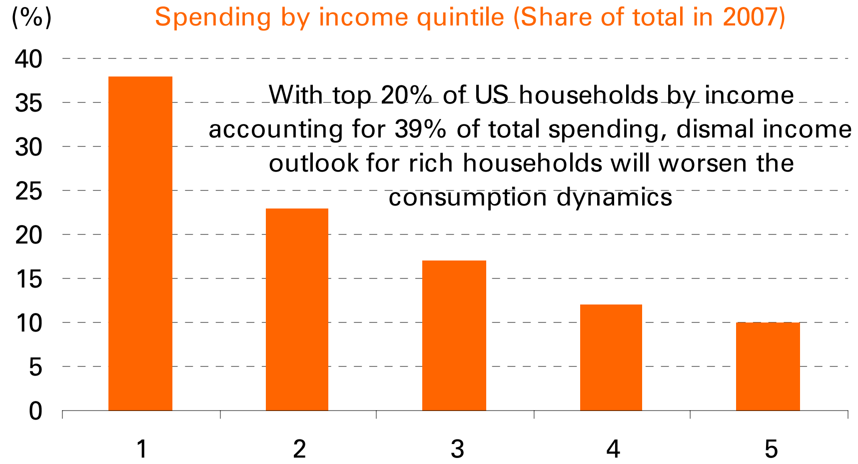
Source: Bloomberg, ICICI Bank Research

Labor outlook going from bad to worse

- The US labor market is in doldrums with total job losses YTD nearing a record 2 million.
- The financial services sector has been the hardest hit in the current recession, losing a massive 246K jobs, the highest across past recessions.
- The unemployment rate is expected to rise further in 2009 from its current elevated level of 6.7% to greater than 7.5%
- The steep fall in temporary help workers, an important gauge of future labor market prospects, does not augur well for the already dismal scenario.
- The ILO has estimated the total global job losses to go up by 20 million by the end of 2009, thereby making the total number of unemployed to a massive 210 mn.

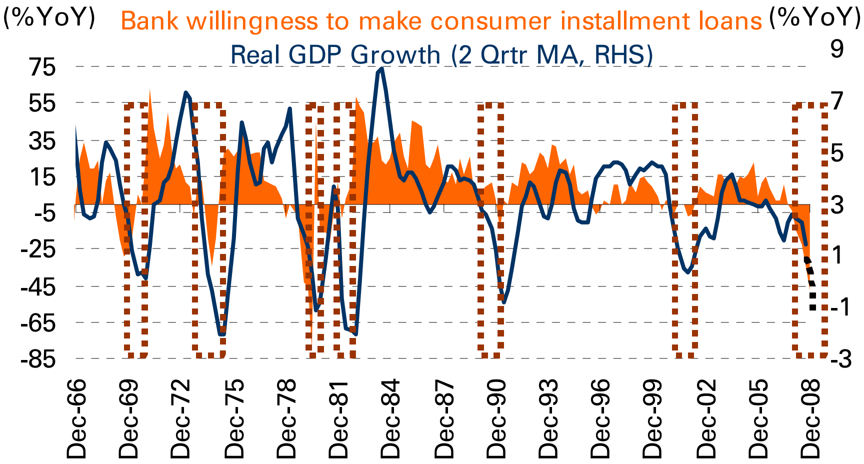
Ongoing crunch to weigh heavily on cash-strapped consumer

US income inequality is at its highest since 1920's



Source: Bloomberg, ICICI Bank Research

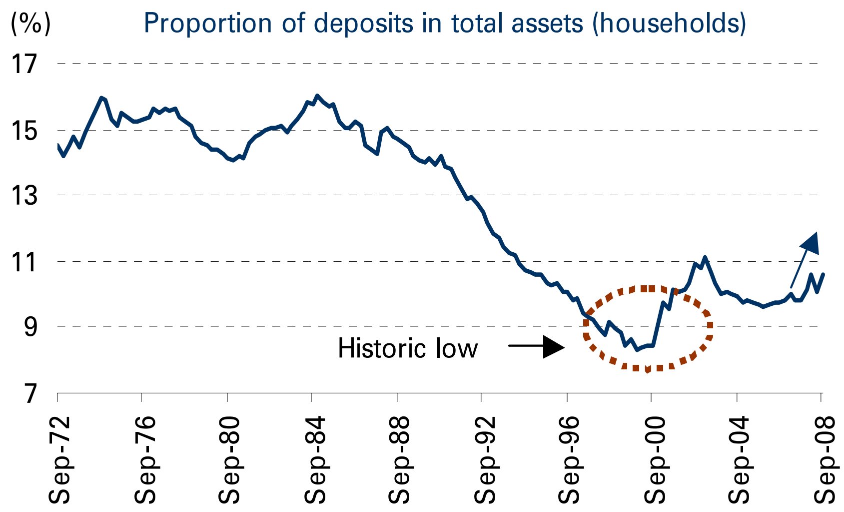
Banks increasingly unwilling to make consumer loans



Box represents recession period

Source: Consumer Expenditure Survey, ICICI Bank Research

Deposit to asset ratio has picked up mirroring a cutback in spending



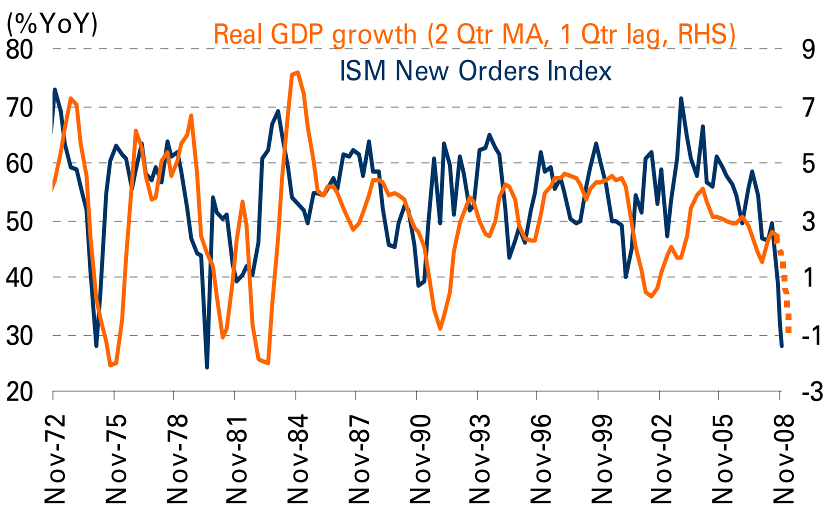
Source: Bloomberg, ICICI Bank Research

Consumption to show more obvious signs of weakness going ahead

- Amidst turbulent global financial and economic conditions , the US households are facing increasing cash flow and balance sheet strains.
- The weakening labor market, tightening credit and depleting household net worth are expected to weigh heavily on consumption expenditure going ahead.
- The pronounced price decline is expected to be the only solace to falling household purchasing power.
- Going into 2009, consumption is expected to show more obvious signs of weakness in the early part of 2009 and then recover gradually over the rest of the year as the impact of another fiscal stimulus takes effect.

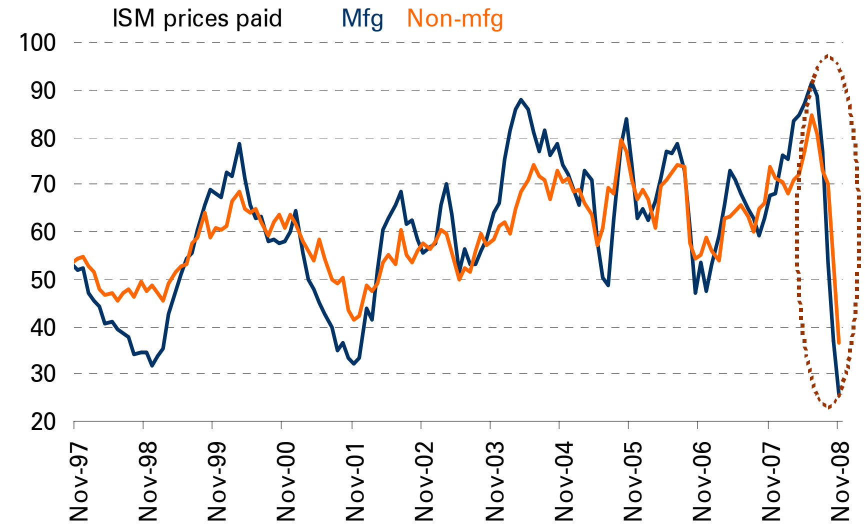
Deteriorating growth outlook increases deflationary risks

Sharp fall in new orders points to a steep fall in business investments



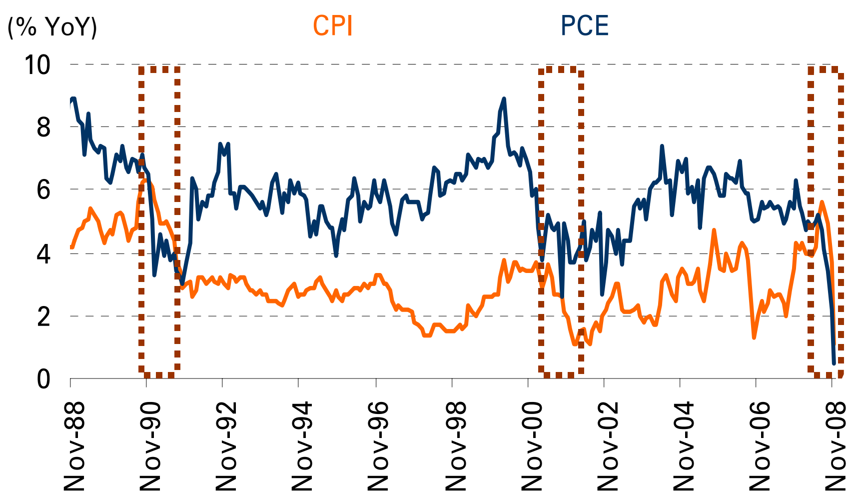
Source: Bloomberg, ICICI Bank Research

Contraction in demand has pulled down manufacturing prices



Source: Bloomberg, ICICI Bank Research

Falling prices and contracting growth indicate deflationary tendencies



Box represents recession period

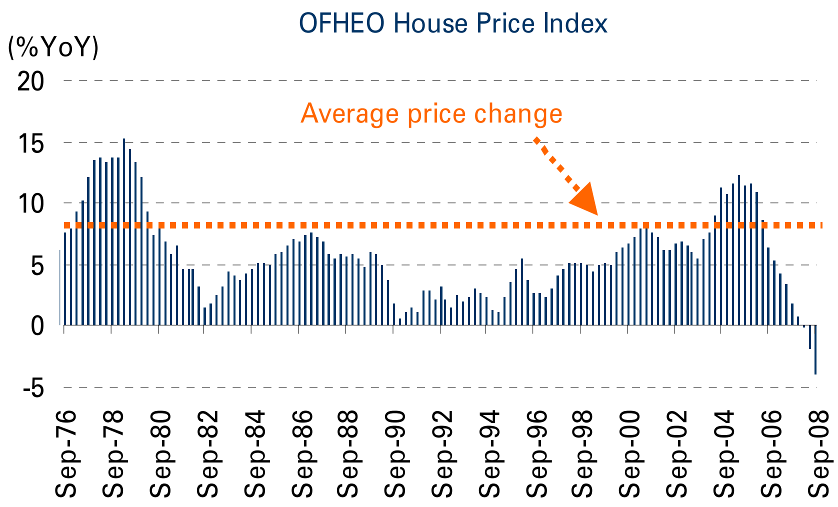
Source: Bloomberg, ICICI Bank Research

Falling prices may trigger a downward spiral thereby prolonging the crisis

- With factory activity showing dismal performance since mid 2008, ISM expects the revenues from the manufacturing sector to decline by 1.1% in 2009 while the non-manufacturing sector might show marginal growth.
- In less than half a year, market concerns of a 1970s like stagflation have swung to fears of a Japan-style deflation amidst a collapse in oil prices along with a slack in overall economy.
- Headline (YoY) inflation has slipped below 1% amidst sharp drops in prices of oil and other forms of energy. Outright declines appear likely in 2009 although the core indexes are decelerating at a still positive rate of around 2% per year.

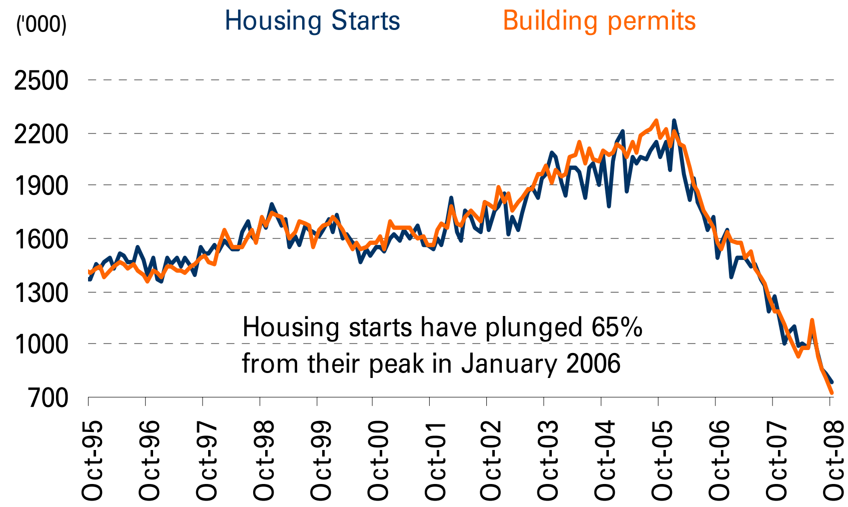
US housing sector continues to be in distress

US house prices have collapsed to historical low levels



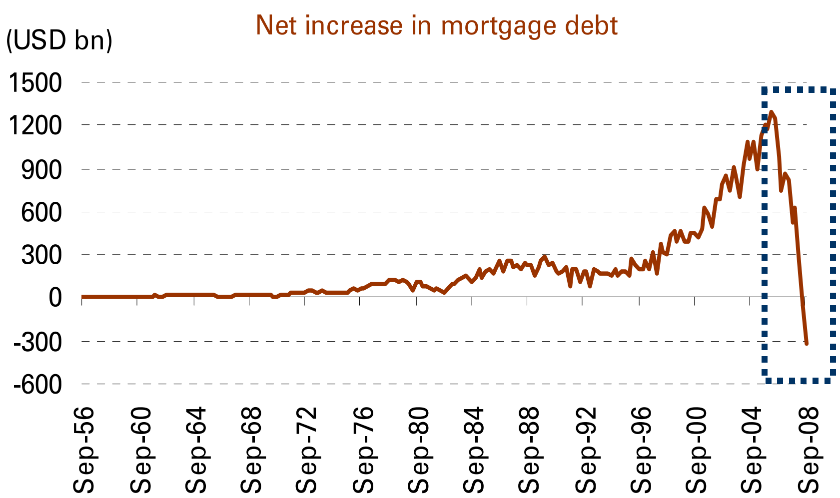
Source: Bloomberg, ICICI Bank Research

Housing starts have touched their lowest levels since 1959



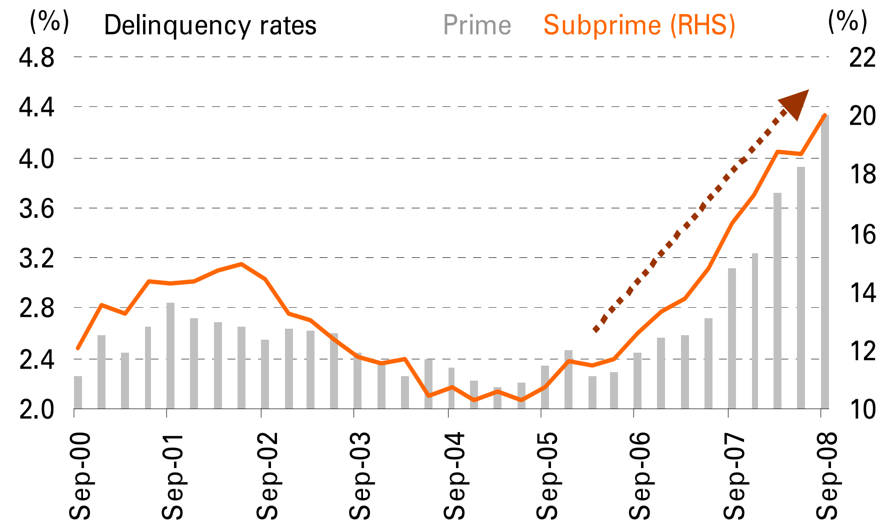
Source: Bloomberg, ICICI Bank Research

Plummeting house prices has weighed heavily on household equity



Source: Reuters Ecowin, ICICI Bank Research

Delinquency rates at all time high



Source: Reuters Ecowin, ICICI Bank Research

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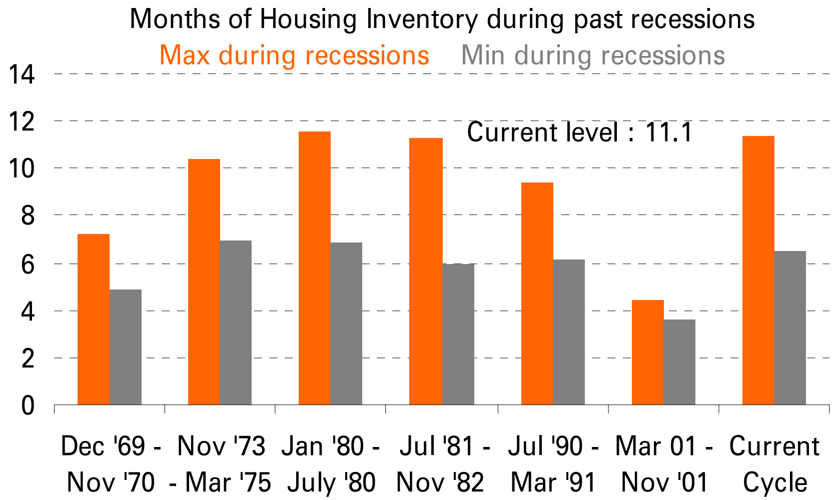
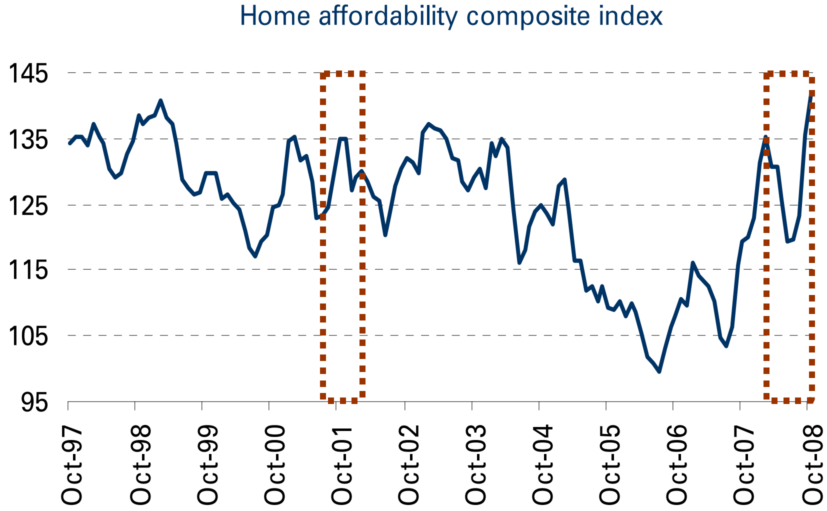
Odd silver linings give hope, but conditions remain dismal

Housing inventory at considerably elevated levels



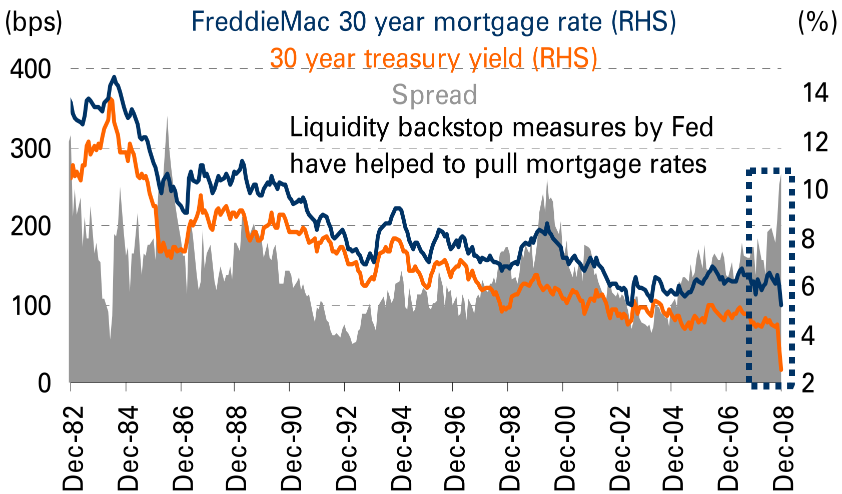
Source: Bloomberg, ICICI Research

Housing affordability has improved



Source: Bloomberg, ICICI Bank Research

Mortgage rates expected to decline further going ahead



Source: EconwIn, ICICI Bank Research

Prospects of housing recovery extremely dim amidst inventory glut

- Amidst the economic meltdown, the US household continue to face depreciating financial and real assets adding severe strains on them. More than 10 million households owe more on their mortgages than the market value of their homes.
- The drop in house prices—in the range of 5% to 17 % over the past year, depending on the index used—is unprecedented since the Great Depression.
- While the improvement in housing affordability and low housing valuations present an odd silver lining, prospects for a housing recovery are extremely dim given the extraordinary excess volumes of unsold and unoccupied homes and more in the foreclosure pipeline.

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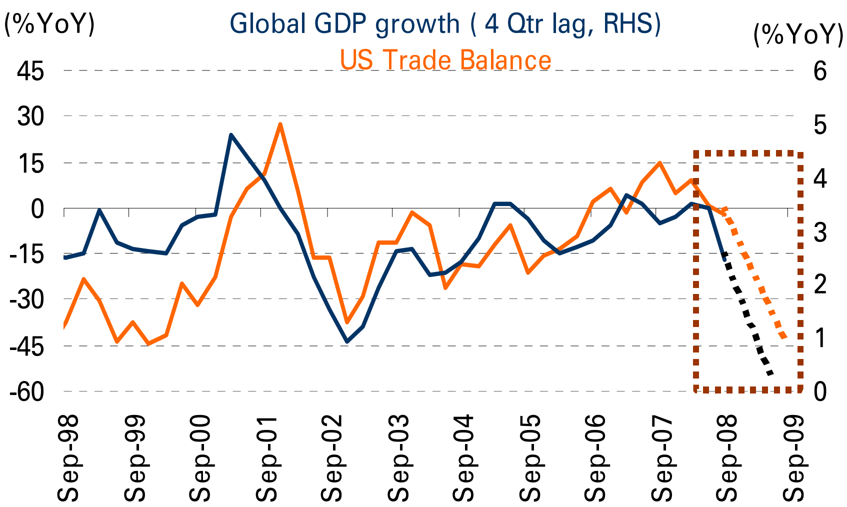
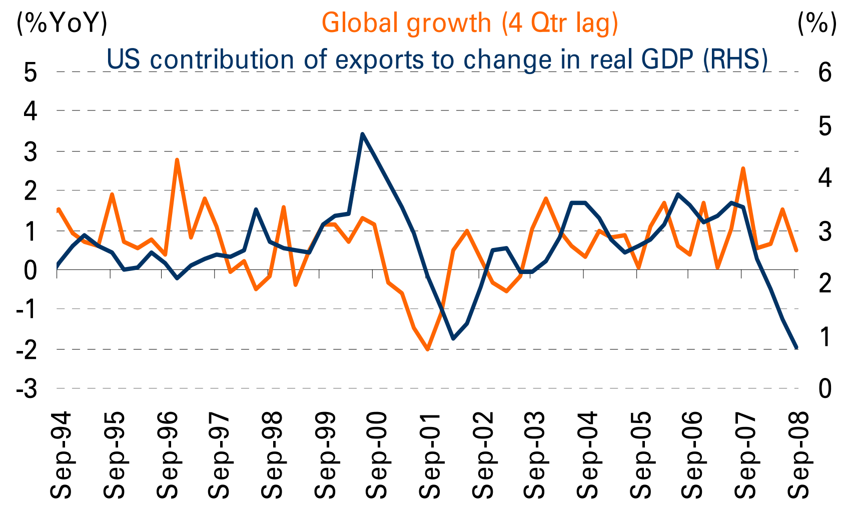
Withering global demand likely to pound US exports further

Sharp downturn in global growth to weigh on US trade balance



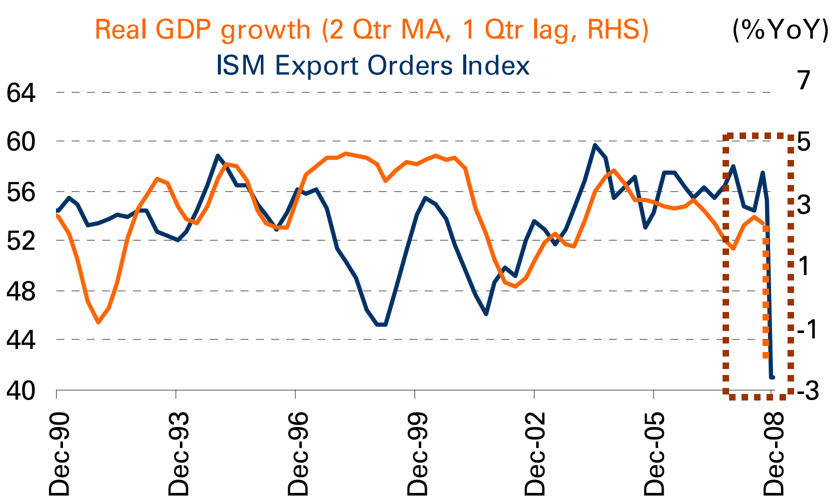
Source: Bloomberg, ICICI Bank Research

US contribution of exports in GDP decline as global production shrinks



Source: Bloomberg, ICICI Bank Research

Decline in US exports orders to drag GDP down



Source: Bloomberg, ICICI Bank Research

Slowdown in China does not augur well for US trade balance

- Despite the sharp fall in crude oil prices, US trade deficit has worsened off late, thanks to a strong dollar coupled with the weakening trends in global economy
- US exports have shrunk to their lowest level in seven months and may worsen further as foreign purchases of US automobiles, chemicals, aircraft and food wane
- However, expected further substantial pullback in US domestic demand is likely to dampen imports, thereby aiding the trade numbers
- Meanwhile, a slowdown in the Chinese economy does not augur well for US in 2009 as China is not only the fastest growing export market for US but also the biggest importer to the country
- According to the World Bank, international trade next year may shrink by 2.1%, the first contraction in more than 25 years

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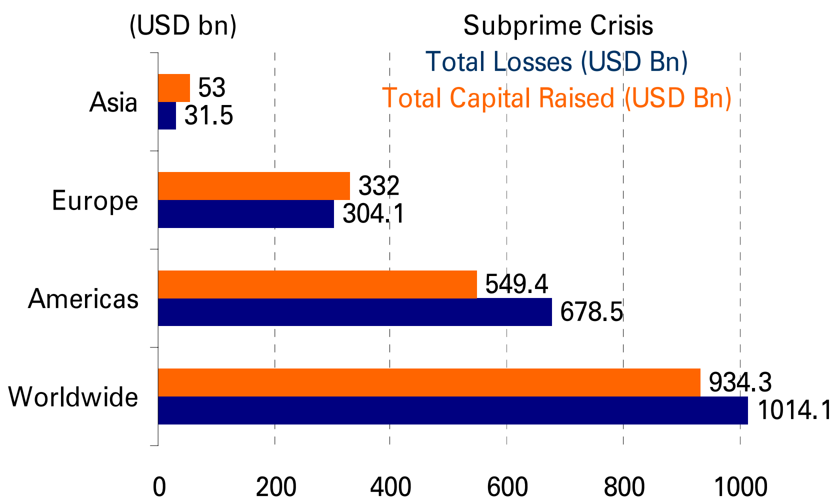
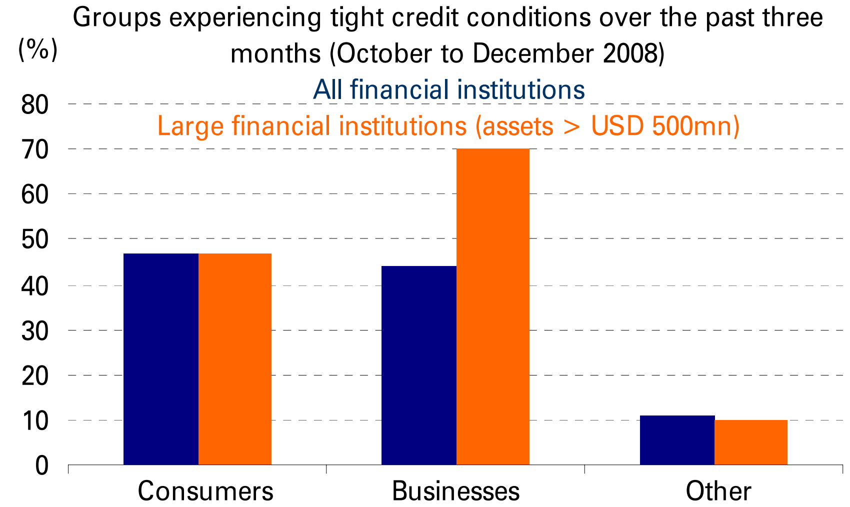
Risk reduction and deleveraging trend to continue in 2009

Capital losses continue to mount, recapitalisation efforts lag behind



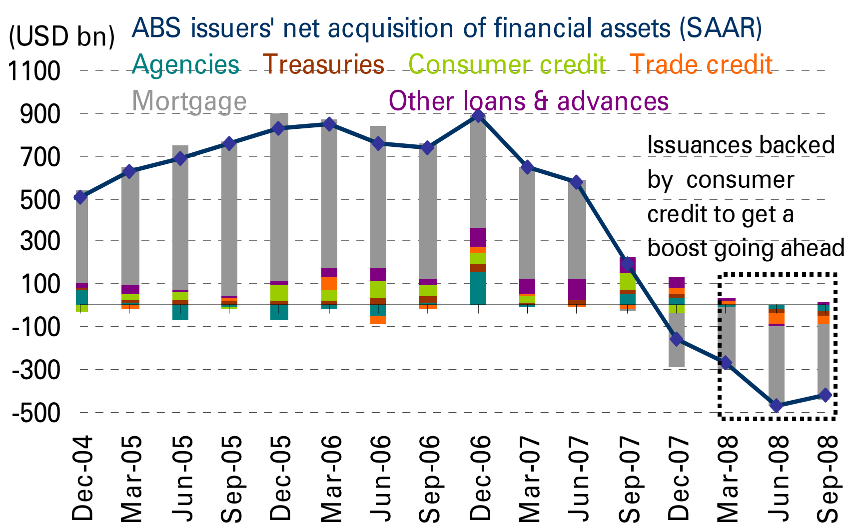
Source: Bloomberg, ICICI Bank Research

Outlook for nonfinancials looks precarious amidst tightening credit lending



Source: Federal Reserve Bank of Minneapolis, ICICI Bank Research

ABS issuers expected to get a major boost following Fed's efforts



Source: Reuters Eco win, ICICI Bank Research

2008 saw massive dislocations in asset pricing, liquidity and funding

- Global Credit markets experienced unprecedented volatility in 2008 amidst massive deleveraging, financial fallouts, dislocation in diverse financial markets and emergence of the worst global recession since two decades.
- Against this backdrop, investment as well as noninvestment grade credit reached record high spread levels.
- In light of the ongoing financial deterioration and forced deleveraging, we expect 2009 to be a year where products and investment strategies are likely to be limited to their simplest forms.
- While the unprecedented levels of market interventions by policy makers would begin to take hold, ongoing real economic weakness will continue to weigh on fundamentals.

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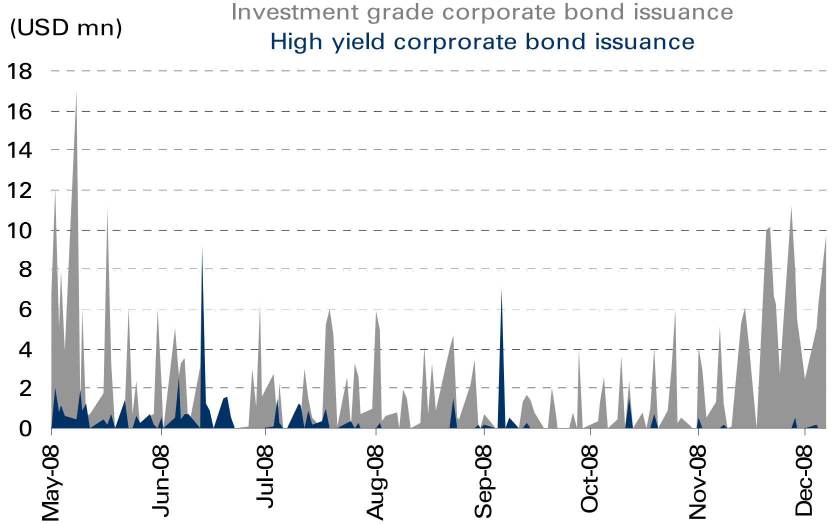
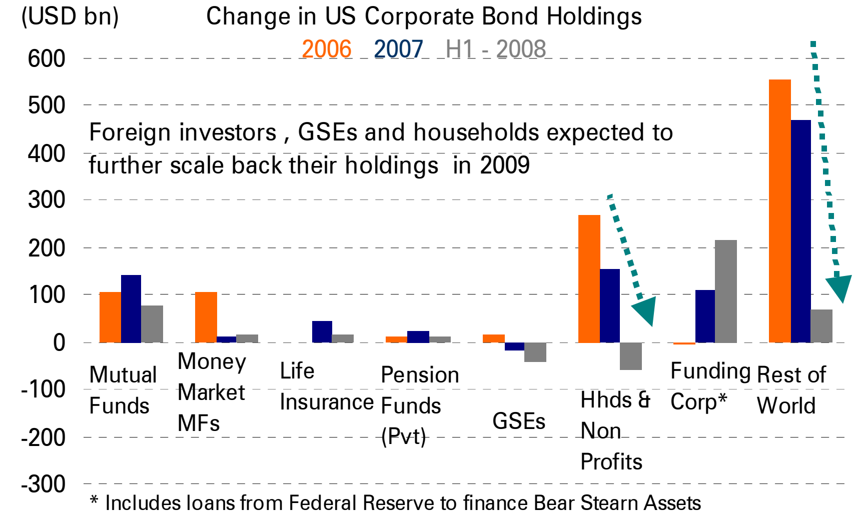
Risk aversion to dominate the corporate bond market as well

High yield issuance has dried up while IG issuance has increased



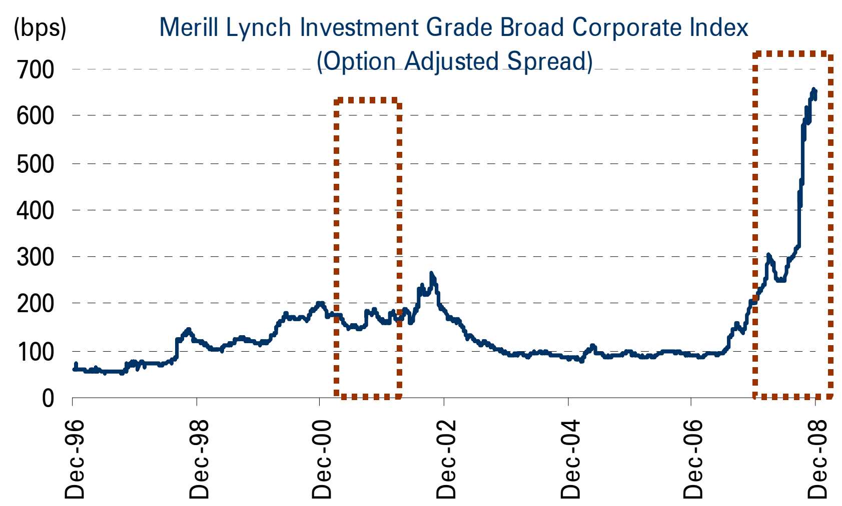
Source: Bloomberg, ICICI Bank Research

Non guaranteed bond issuance expected to decline further in 2009



Source: Bloomberg, ICICI Bank Research

Investment grade corporate bond yields have touched record high levels



Source: Bloomberg, ICICI Bank Research

Focus on effects of policy efforts to determine investment strategy

- Faced by one of the worst financial crisis in history, US authorities have been proactive in dealing with immediate threats to systemic stability and are expected to pass several more initiatives to stem the crisis
- In addition to the USD 700 bn TARP, so far the total gross lendings under various Fed lending programs amount to a massive USD 6.373 tn
- Meanwhile, demand for FDIC guaranteed US corporate debt is expected to rise significantly in 2009 given its strong backing ("full faith and credit") by US government and its relatively attractive yield for the credit risk.
- Liquidity and tradability would be two crucial factors for attracting investor interest across markets in the forthcoming year

Plethora of event risks dominate US credit outlook in 2009

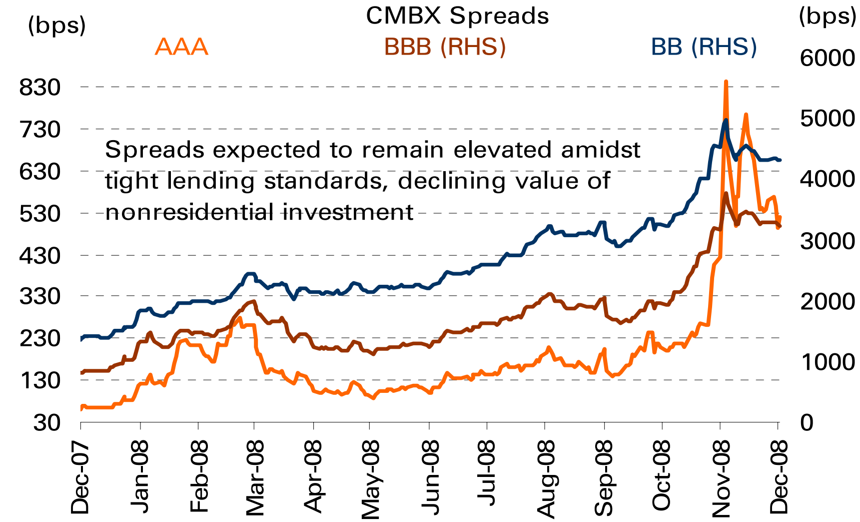
Rating downgrades may trigger another collapse, deepen the crisis

Standard & Poor's credit rating downgrades of major financials			
Bank	New Rating	Previous Rating	Outlook
Bank of America	A+	AA-	Negative
Barclays Bank PLC	AA-	AA	Negative
Credit Suisse	A+	AA-	Stable
Citigroup	A	AA-	Stable
Deutsche Bank	A+	AA-	Stable
Goldman Sachs	A	AA-	Negative
HSBC*	AA-	AA-	Negative
JP Morgan Chase	A+	AA-	Negative
Morgan Stanley	A	A+	Negative
UBS	A+	AA-	Stable
Wells Fargo	AA	AA+	Negative

*Rating was unchanged but the outlook was downgraded from stable

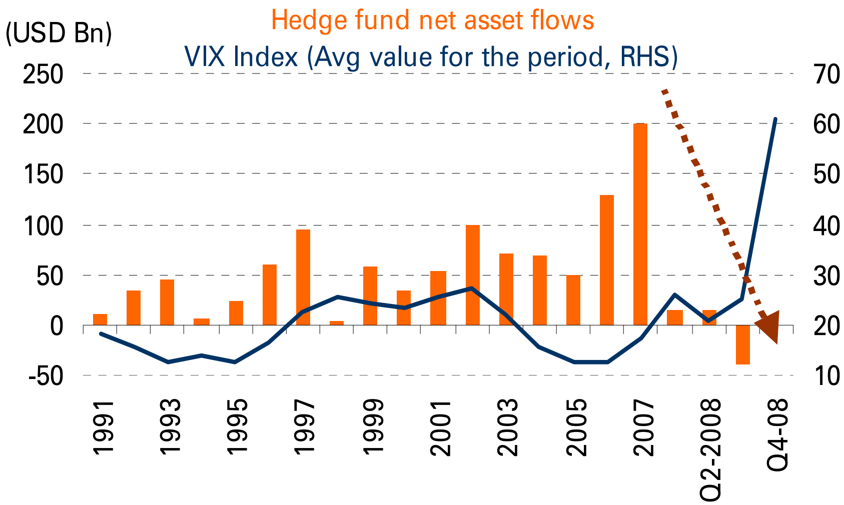
Source: Bloomberg, ICICI Bank Research

Commercial Real Estate – unprecedented downturn in offing



Source: Bloomberg, ICICI Bank Research

Vicious cycle of develeraging and risk aversion to continue in 2009



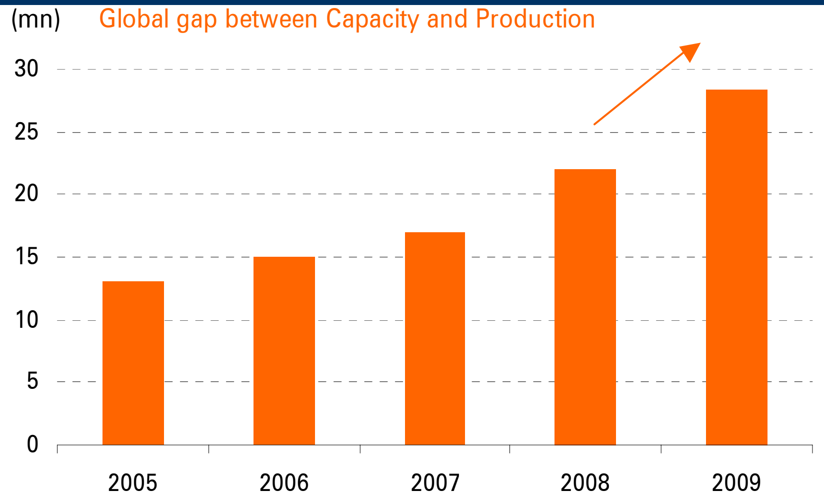
Source: Hedge Fund Research, Bloomberg, ICICI Bank Research

Market conditions set to remain difficult in 2009

- Risks for the banking industry remain elevated amidst fears of further rating downgrades of several major financials including Goldman Sachs, UBS, Deutsche Bank as well as municipal bond guarantors
- Meanwhile, the outlook for the commercial real estate market remains bleak with more than USD 400 bn of outstanding mortgages (total USD 3.4 tn) expected to come due through 2009 when credit is practically non existent and cash flows from commercial property are siphoning off
- The consumer finance sector, which includes credit cards, student loans and auto finance, is also expected to take a hit as domestic demand withers while investors remain wary despite several policy measures

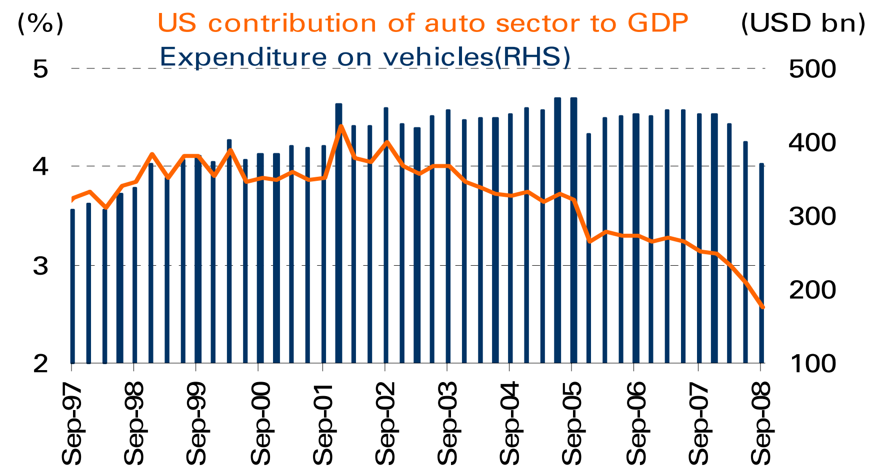
Disorderly bailout of auto industry could add to the event risks

Failure of US auto industry could set off catastrophe



Source: CSM Worldwide, ICICI Bank Research

Global auto production expected to slump much below capacity



Source: BEA, ICICI Bank Research

Auto industry battles the slump

Collapse of Detroit 3

Massive job losses

Direct Employment	239,341
Indirect Employment (Suppliers)	973,969
Other expenditure induced jobs*	1738034
Total	2,951,344

Reduction in personal income

Loss on US Government fiscal operations

- Increase in transfer payments
- Reduction in Social Security Receipts
- Reduction in personal income taxes paid

* Estimated by Centre For Automotive Research

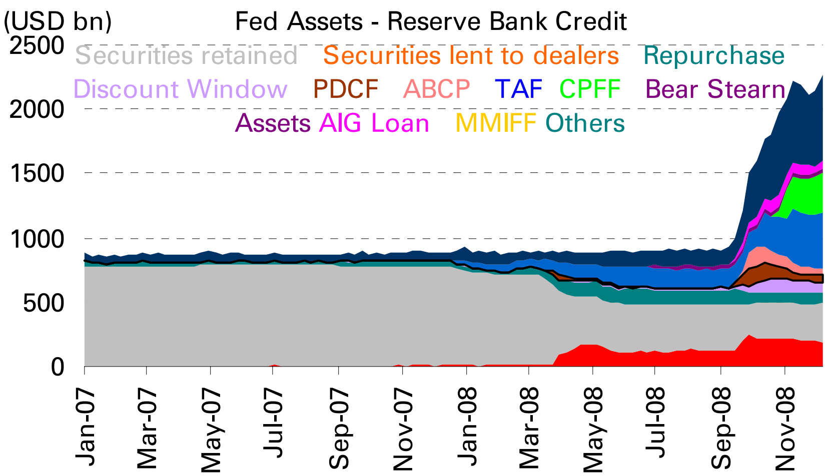
Source: CAR Research, ICICI Bank Research

Global automakers plight may deepen recession even with government aid

- In a move to avoid bankruptcy, White House has unveiled a USD 17.4 bn rescue package for the troubled Detroit auto makers
- However, with US auto sales having plummeted to a 26 year low on just 10.2 mn units in November, the deal is unlikely to put the automakers on a long term path to viability
- Amidst a deteriorating economic environment and weakening demand, production is expected to decline further in 2009. The inventory buildup in 2008 is estimated to be a massive 800K as compared to an average of 200K earlier
- While the US auto industry faces a wave of downsizing, manufacturers elsewhere, stretching from China to Europe, have also announced substantial production cuts and are seeking government help

Policy action moves into uncharted territory

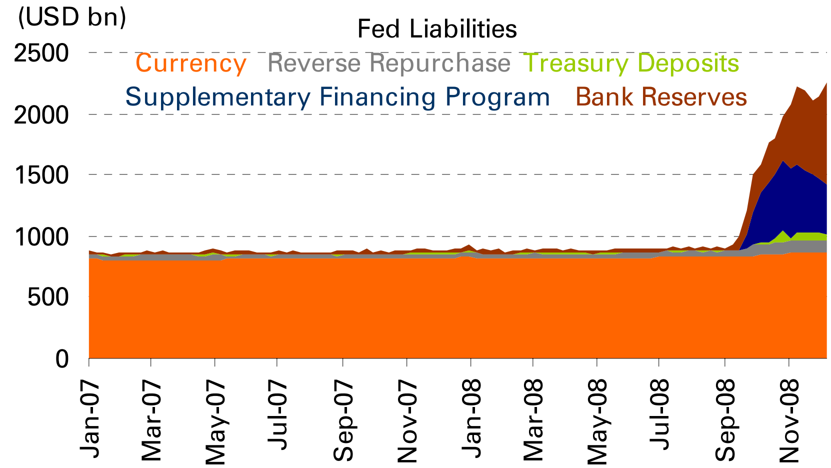
Funds injected by Fed through various unconventional measures…



Note:MMIF facility has not been used so far

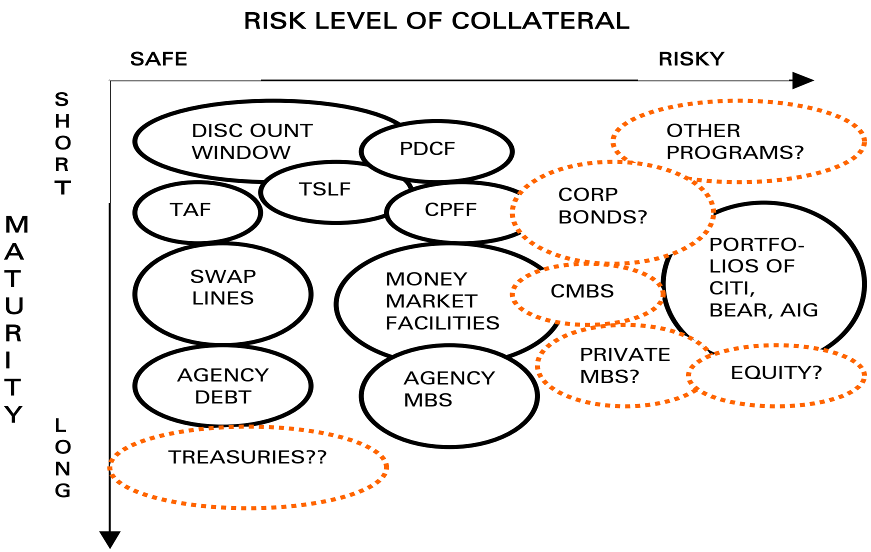
Source: Bloomberg, ICICI Bank Research

… are being accumulated as excess bank reserves



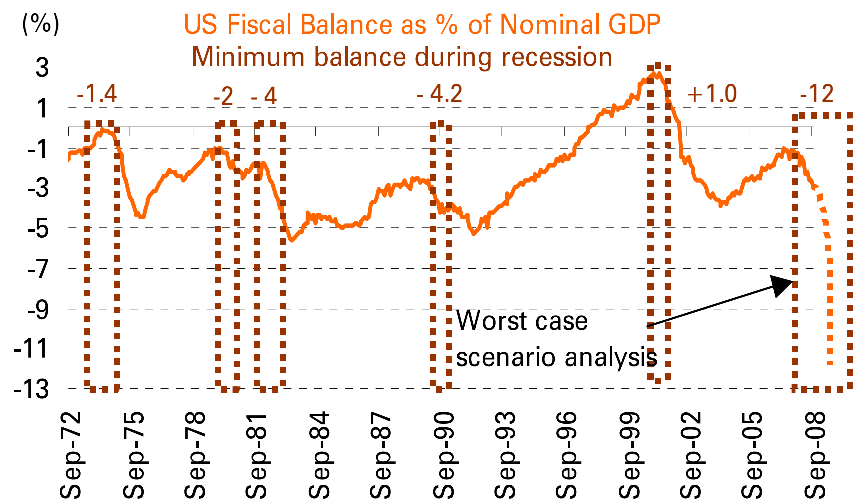
Source: Bloomberg, ICICI Bank Research

Fed expected to expand the risk profile of its asset portfolio



Source: ICICI Bank Research

Going into 2009,fiscal policy would play a crucial role in supporting growth

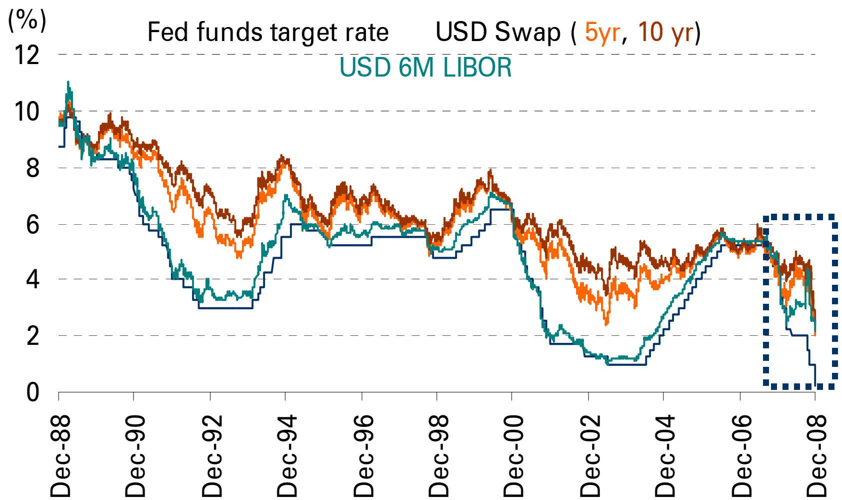


*Box represents recession period

Source: Bloomberg, ICICI Bank Research

Balancing risks of ongoing unconventional monetary measures

Focus shifts to Quantitative Easing

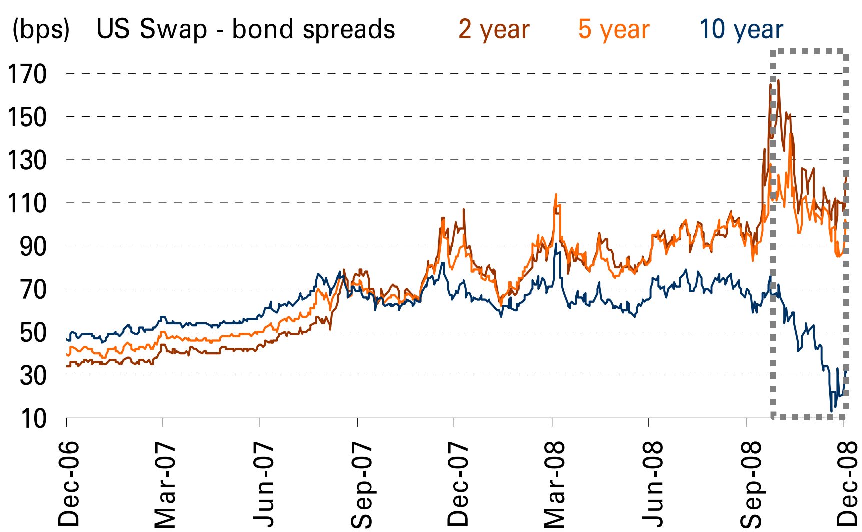


Source: Bloomberg, ICICI Bank Research

Coordination between fiscal and monetary policy all the more vital

- With the Fed having embarked on quantitative easing we expect it to remain on hold for a long time until policy makers are assured that a self feeding cyclical recovery is underway
- The Fed's policy stance highlights the imminent danger of a deep and protracted recession in the US economy with risks of deflation looming large. We do not expect economic as well as financial conditions to recover in 2009 to warrant any interest rate change
- Going into 2009, the distinction between fiscal and monetary policy would fade as the Fed would have to play a vital role in the effective implementation of any fiscal policy by carefully balancing the risks of the ongoing unconventional monetary measures

IRS spreads expected to collapse, but upside risk remains



Source: Bloomberg, ICICI Bank Research

Substantial downside risks to US dollar over the medium to long term

- IRS spreads are likely to narrow further going ahead given the positive impact of Fed's liquidity measures along with a rollout of quantitative easing measures
- However, the decline may be gradual and swap spreads as well as interbank rates may remain sticky as global markets still remain in risk-aversion mode amidst ongoing write-down's, capital losses and fallouts
- We expect the US dollar to remain under pressure in the later part of 2009 as dollar funding pressures recede amidst massive liquidity injection, and long term US treasuries become a less attractive option following yield declines
- Having said this, upside risks to the dollar cannot be completely discounted, as the deleveraging may catch pace if credit conditions worsen substantially in non US economies

Euro-zone

The first ever EZ recession could turn out to be the ugliest in times to come

As financial tensions spill over to the real economy, firms in for a tough time

Fiscal consolidation to be side-stepped in an effort to stimulate growth

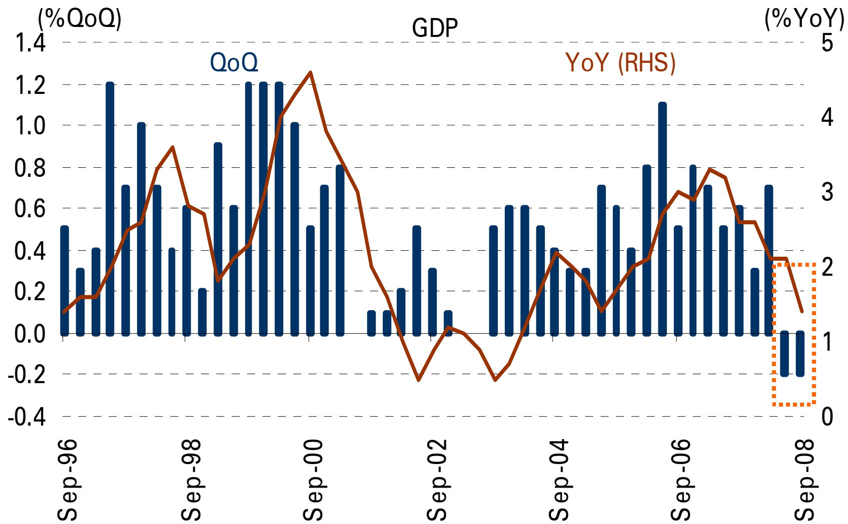
“Balanced” inflation risks allow ECB to loosen policy

ECB likely to go down in a measured fashion

Divergence in policy action to support Euro against major crosses

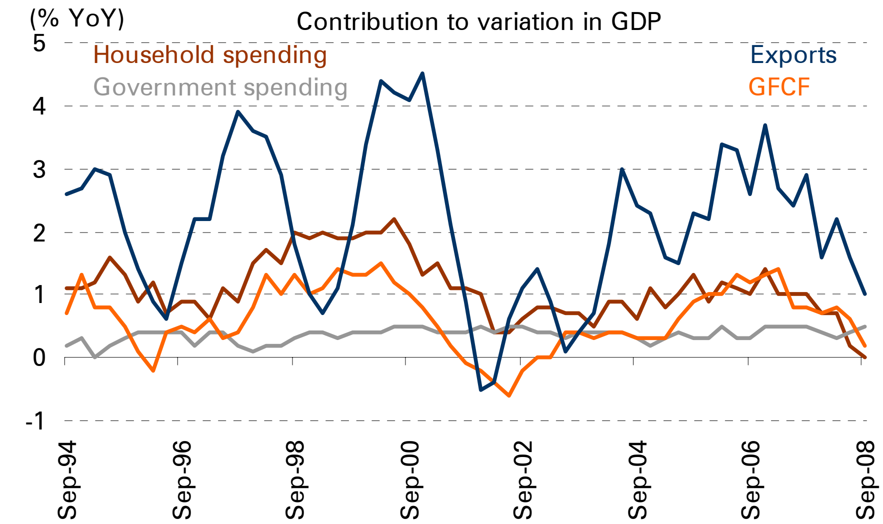
Euro zone under threat of a severe recession

EZ enters its first ever recession…



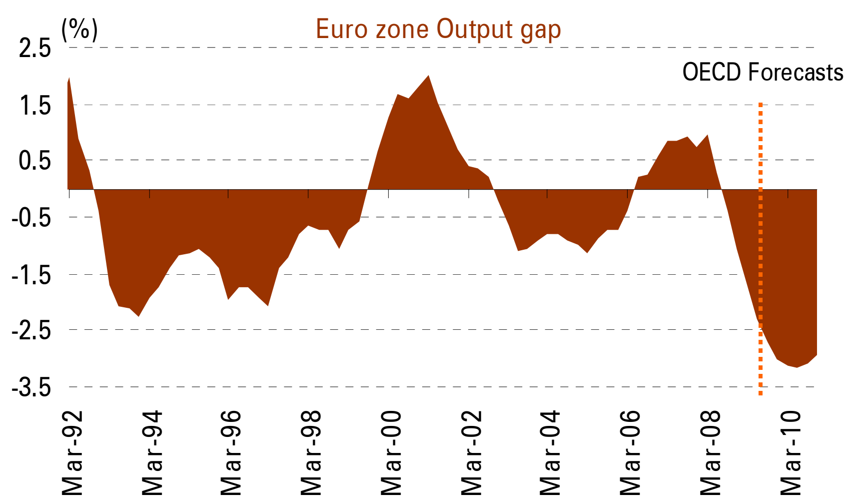
Source: Bloomberg, ICICI Bank Research

…as support from all sectors falls through one after the other



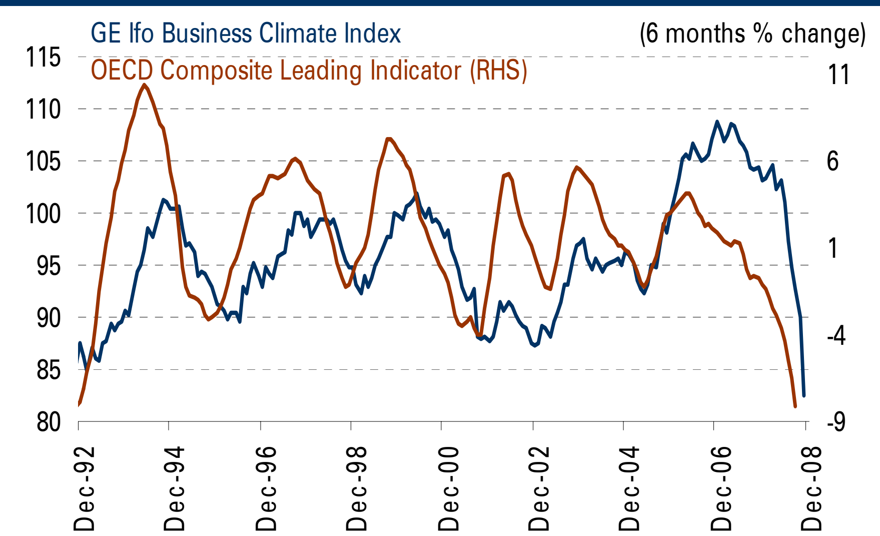
Source: Bloomberg, ICICI Bank Research

Economic pain is likely to worsen with output gap seen to widen further…



Source: OECD, ICICI Bank Research

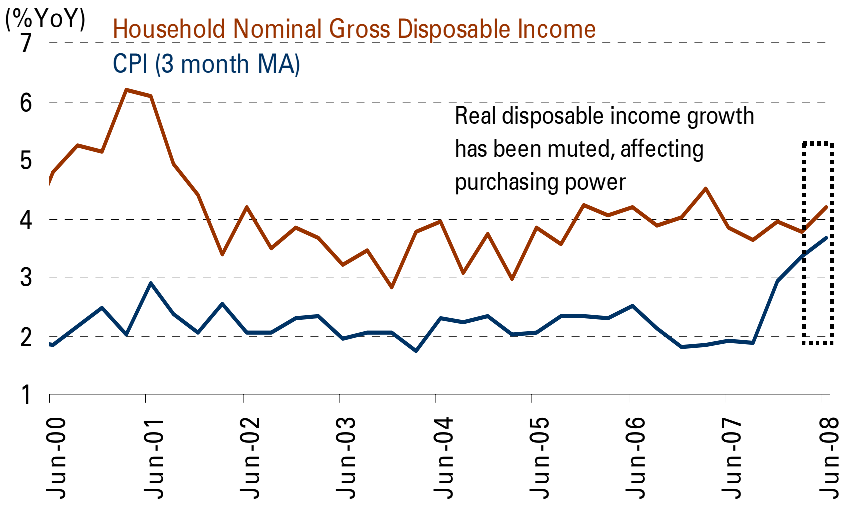
…and leading indicators at levels below those seen during 1990s downturn



Source: Bloomberg, OECD, ICICI Bank Research

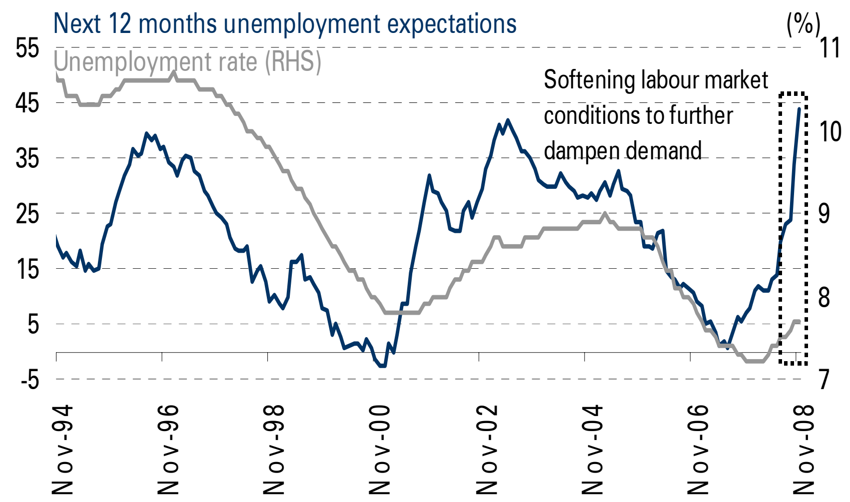
Consumers feeling the squeeze from all sides

While earlier record high consumer prices had eroded purchasing power



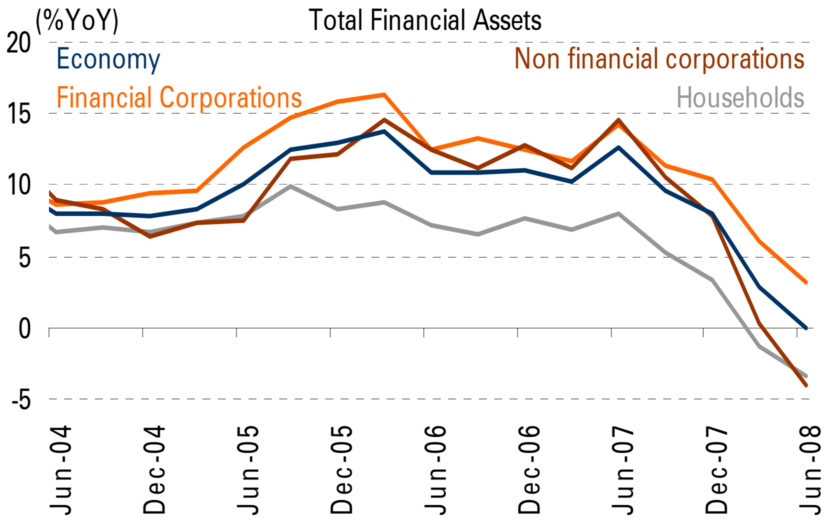
Source: Reuters Ecowin, ICICI Bank Research

Now, it is easing labour market conditions with growth virtually stalling…



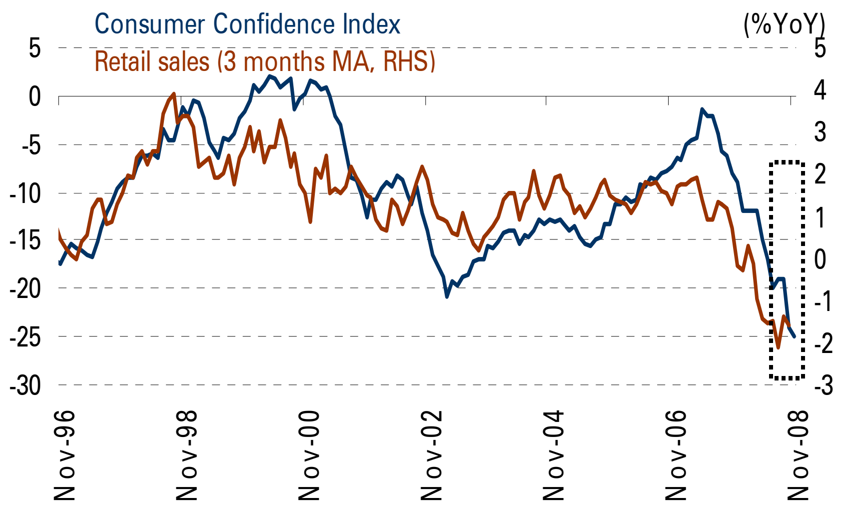
Source: Bloomberg, ICICI Bank Research

…along with the erosion of household financial wealth…



Source: Reuters Ecowin, ICICI Bank Research

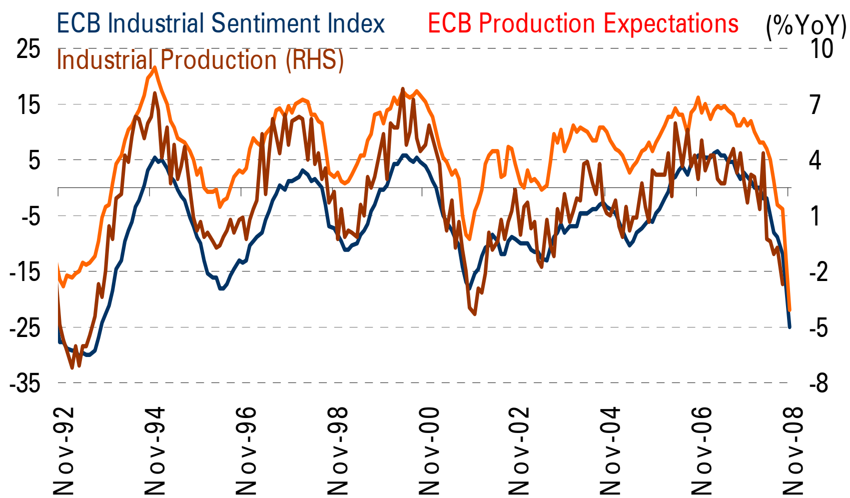
…which is weighing heavily on consumer sentiment and demand



Source: Bloomberg, ICICI Bank Research

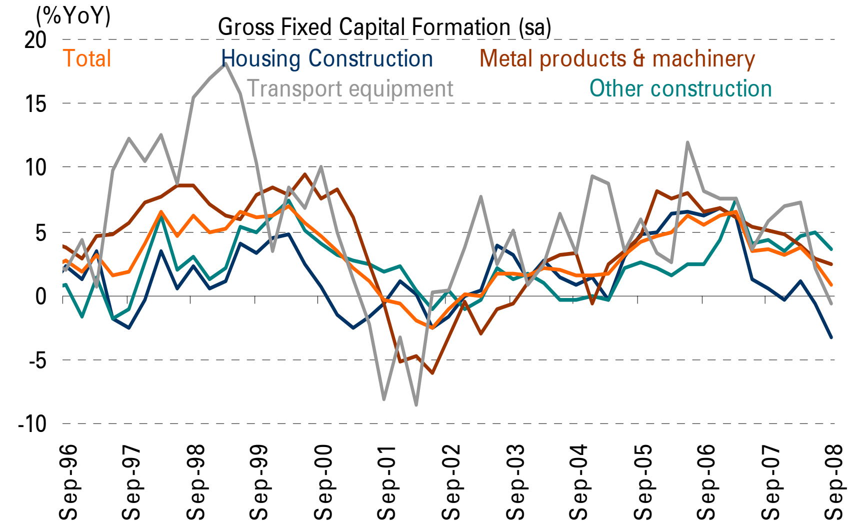
Even progress on the industrial front has come a cropper

No respite yet for industrial sector as sentiment plunges to new lows



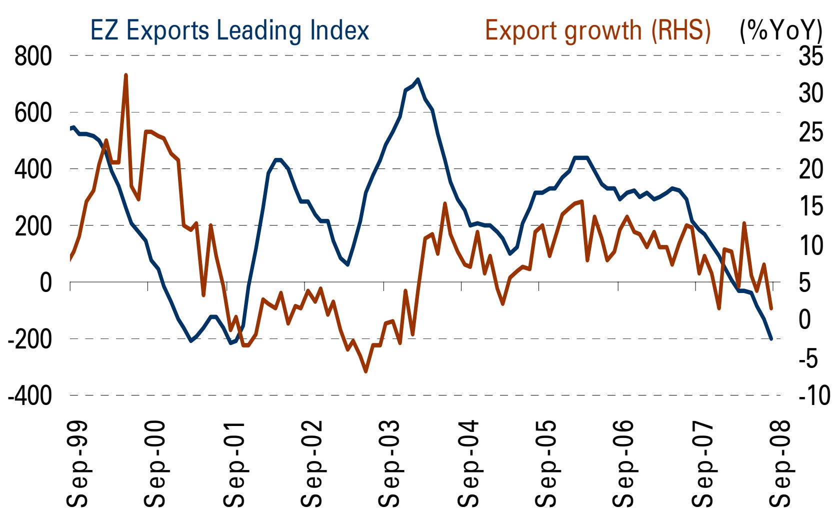
Source: Bloomberg, ICICI Bank Research

Investment activity, esp. housing, falls sharply as economic woes deepen



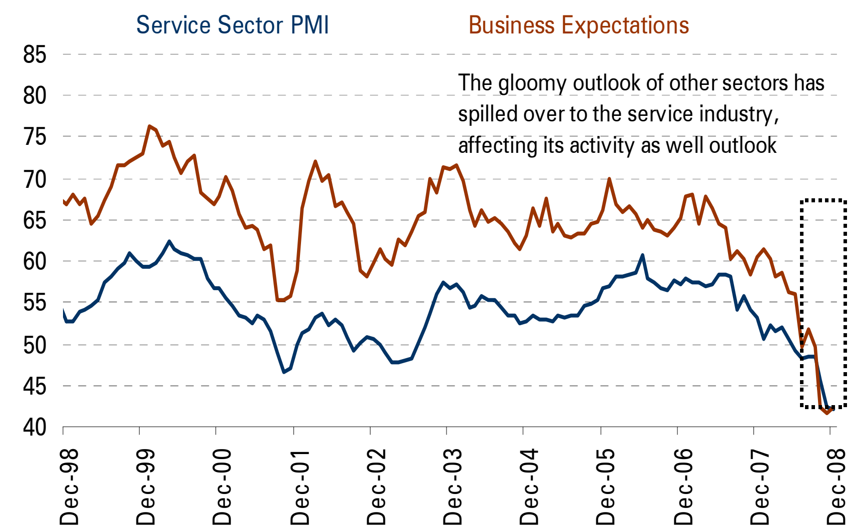
Source: Reuters Ecowin, ICICI Bank Research

Support from external sector unlikely as major export markets feel the heat



Source: Reuters Ecvowin, ICICI Bank Research

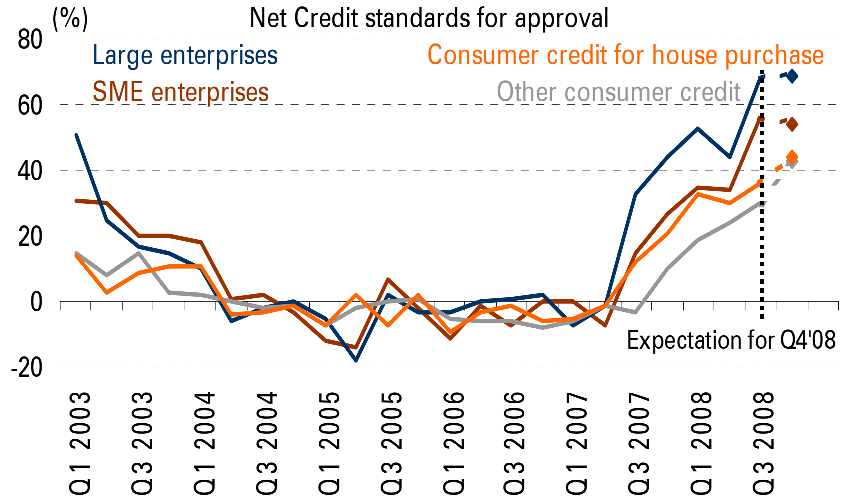
Services, dependent on other sectors for growth, also under pressure



Source: Reuters Ecowin, ICICI Bank Research

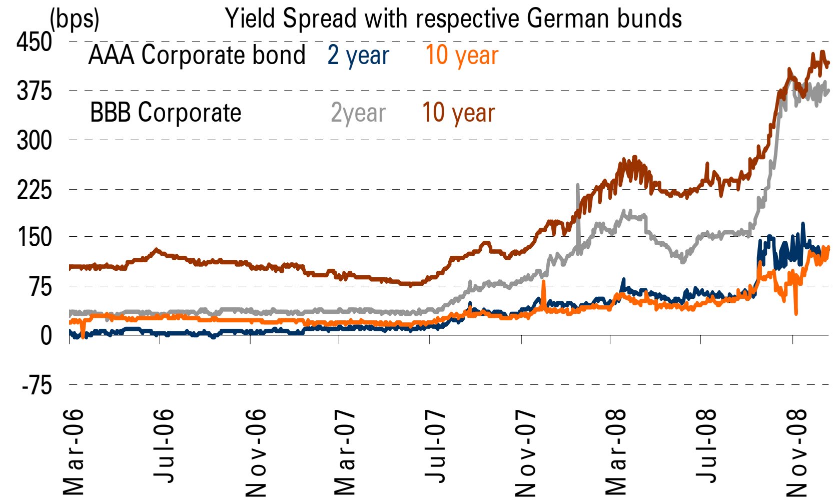
Tough times ahead for corporates

With capital already a scare resource, the tight lending standards and…



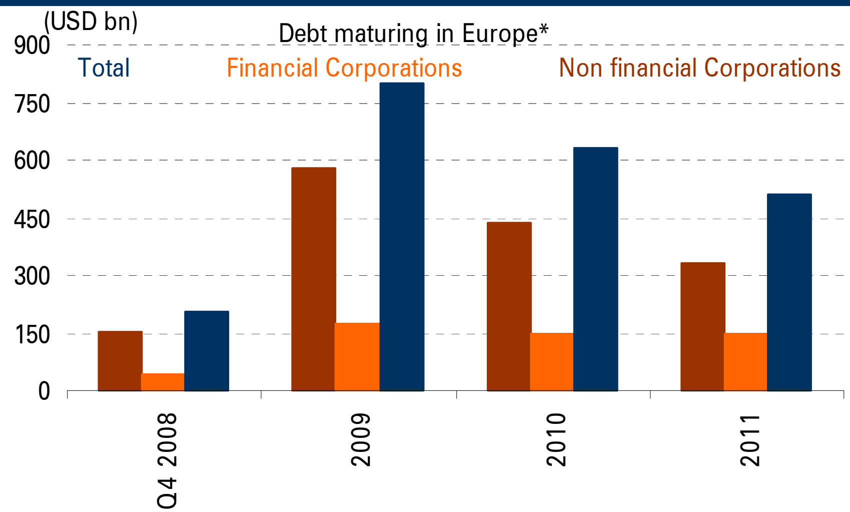
Source: ECB, ICICI Bank Research

…higher borrowing costs facing firms could pose a problem…



Source: Bloomberg, ICICI Bank Research

…especially in rolling over the huge debt maturing next year

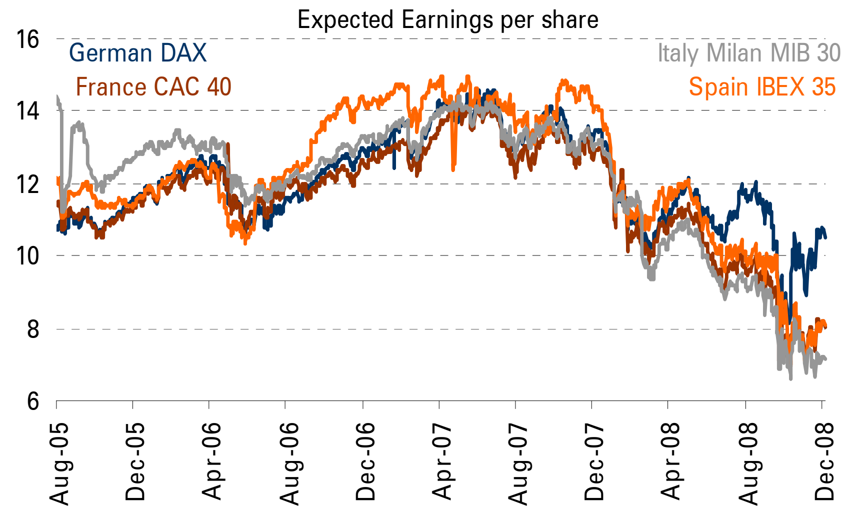


*Europe includes Europe, some Middle east and African economies

Data as of 22nd Oct'08

Source: S&P, ICICI Bank Research

This, with the grim growth prospects has led to bleak earnings outlook

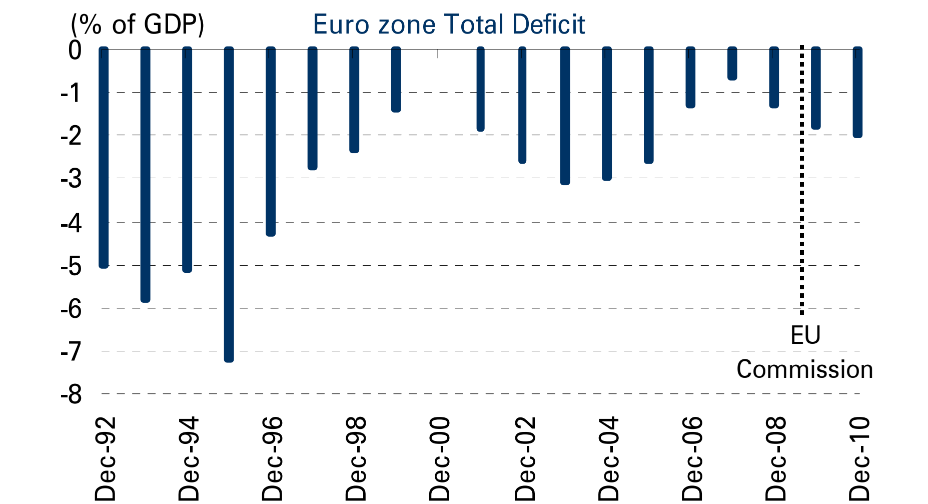


Source: Bloomberg, ICICI Bank Research

ICICI Bank Corporate Solutions

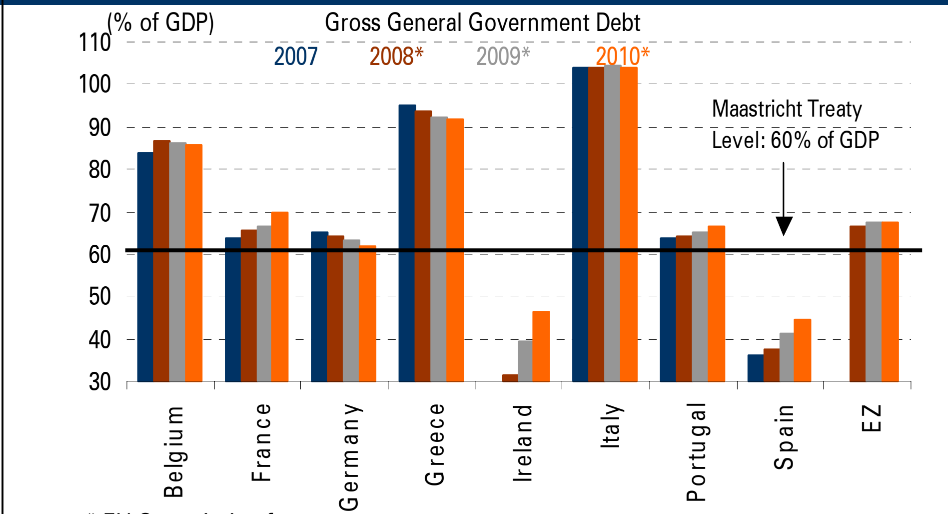
Fiscal health set to deteriorate

Various fiscal stimulus packages to reverse the earlier fiscal consolidation...



Source: Reuters Ecowin, ICICI Bank Research

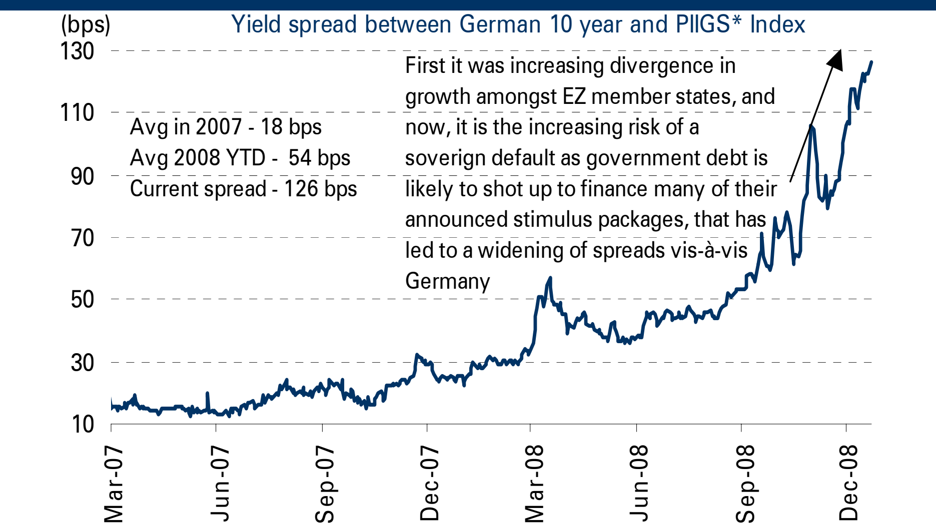
...and lead to an increase in government borrowing



* EU Commission forecasts

Source: EU Commission, ICICI Bank Research

Risk of government default has led to a widening of the sovereign spread



* constructed as weighted avergae of the 10 year yields of Portugal, Ireland, Italy, Greece and Spain

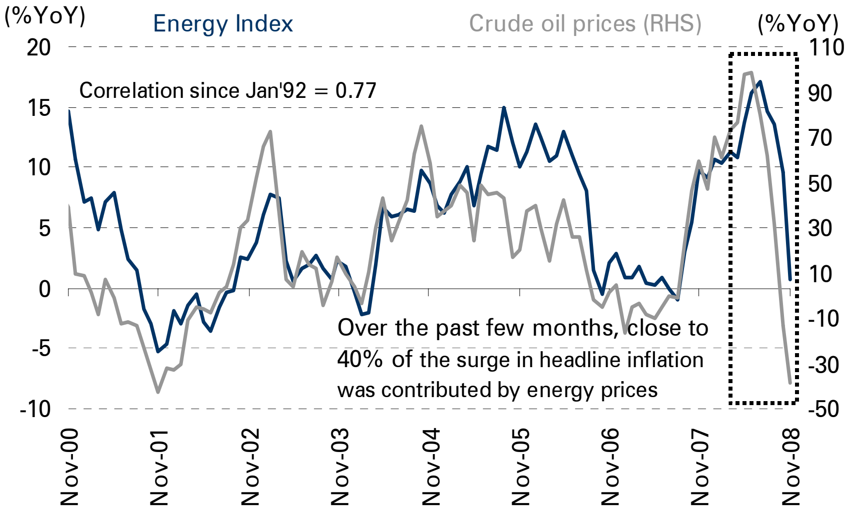
Source: Bloomberg, ICICI Bank Research

Stimulating growth at the forefront of government policies

- Attention has shifted from shoring up the financial sector to shoring up the real economy
- Stimulus packages announced by EU member states differ significantly - those by U.K and Spain are aimed at supporting consumers and housing, while those by Germany and France are more focused on government spending particularly related to infrastructure
- With government fiscal health all set to deteriorate, EU rules of budget stability are at risk. However, under these unusual and unprecedented circumstances, EU Commission has allowed for temporary relaxation of these rules. But governments are expected to comply with the same in the future by tightening their purses

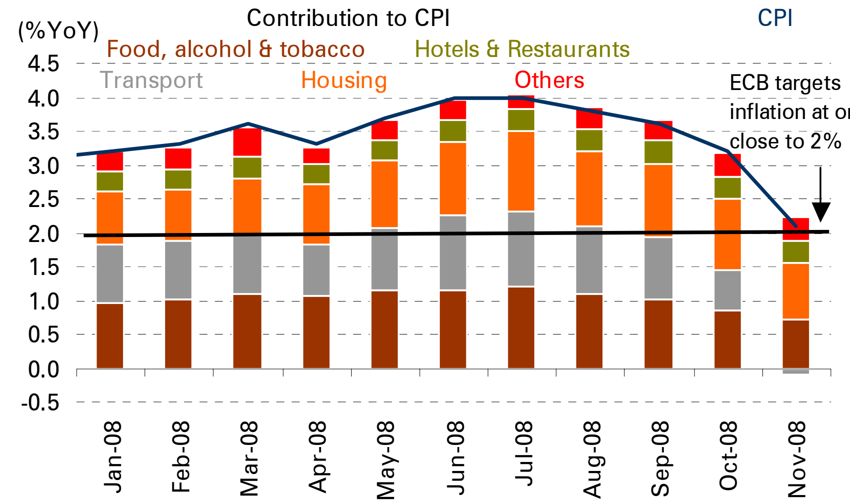
“Balanced” inflation risks allow ECB to loosen policy

The near collapse of global oil prices has helped to ease price pressures…



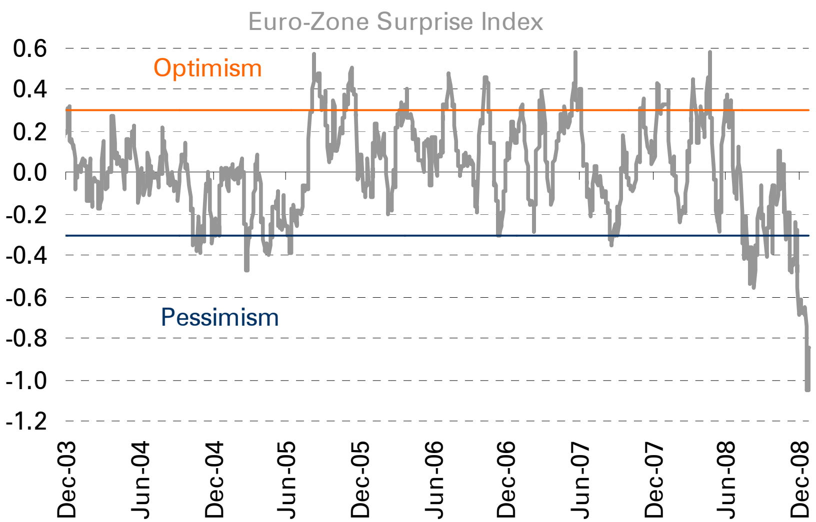
Source: Bloomberg, ICICI Bank Research

…with consumer prices now nearly in line with price stability



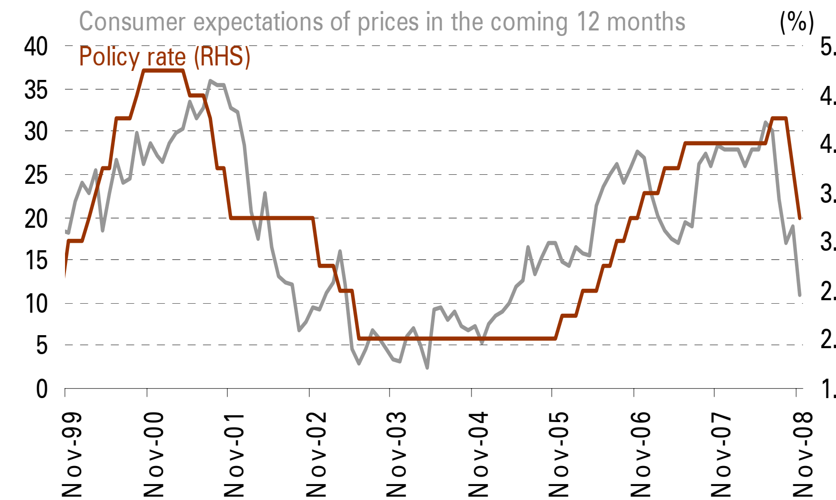
Source: Bloomberg, ICICI Bank Research

This together with the sharp turnaround in growth outlook has not only…



Source: Bloomberg, ICICI Bank Research

…brought down price expectations, but also allowed for policy easing

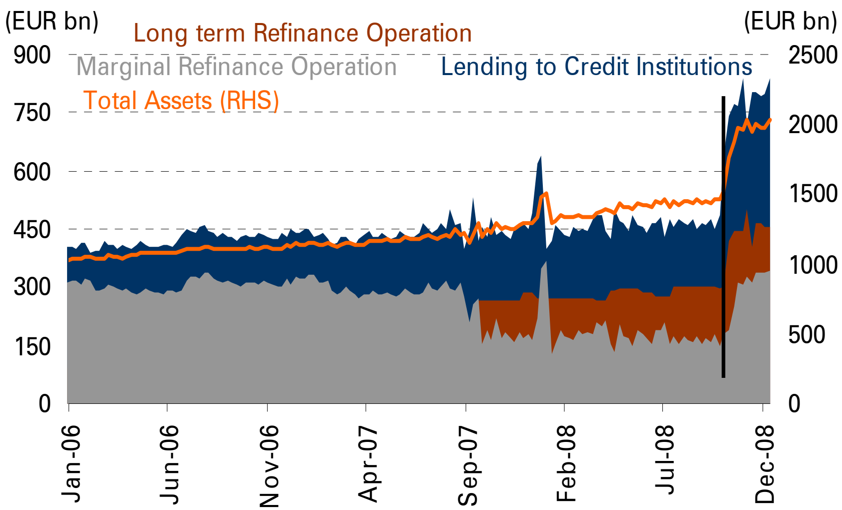


Source: Bloomberg, ICICI Bank Research

ICICI Bank Corporate Solutions

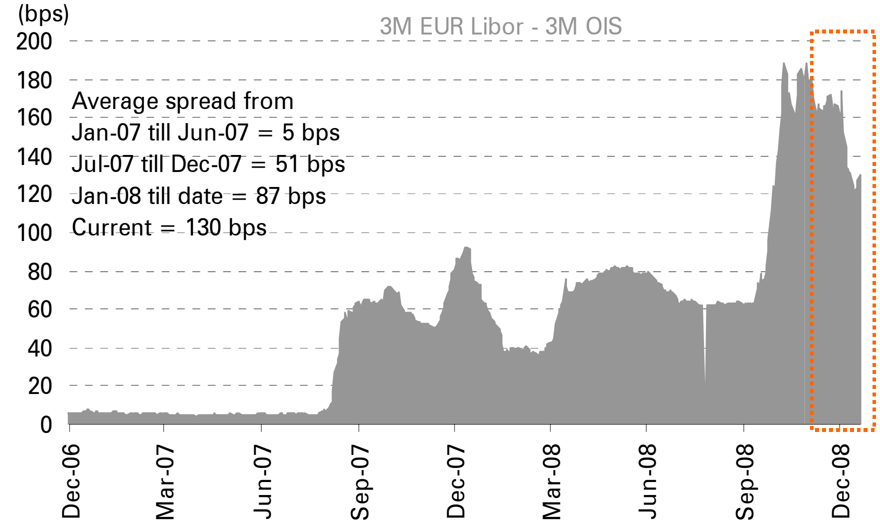
ECB likely to go down in a measured fashion

ECBs balance sheet has ballooned as it has pumped in massive liquidity to



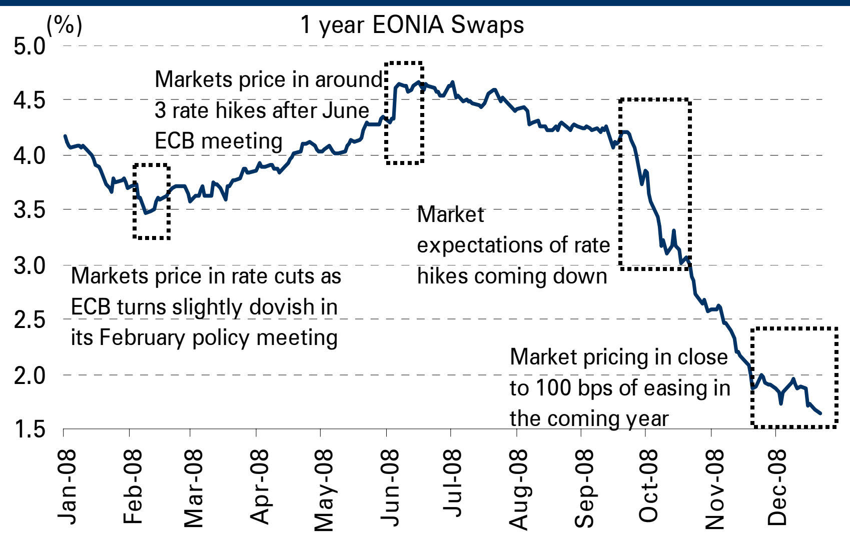
Source: Bloomberg, ICICI Bank Research

…help normalize money markets, but tensions continue to persist



Source: Bloomberg, ICICI Bank Research

ECB to go lower as financial markets remain dislocated, and growth falters



Source: Bloomberg, ICICI Bank Research

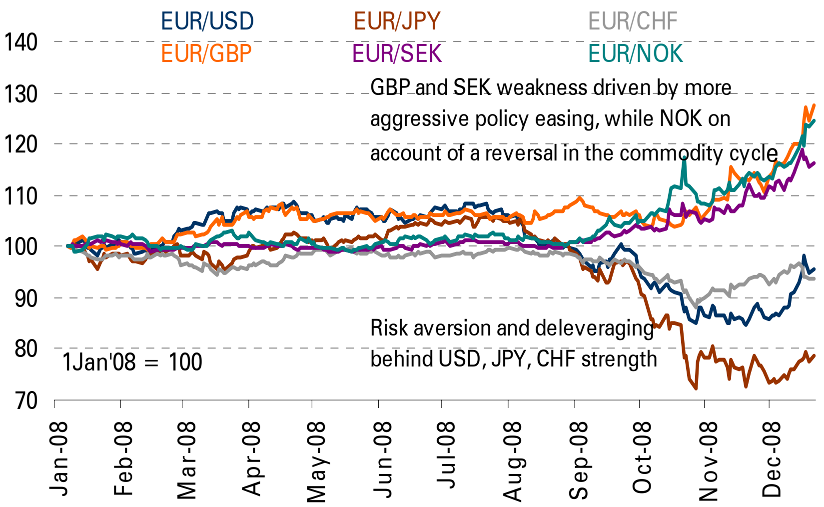
Monetary Policy Outlook

- Even as growth risks have been rising (growth to lie between –0.6 to 0.3% in 2009), ECB has been able to aggressively ease rates to 2.5% from a peak of 4.25% only as price risks have dissipated (CPI to lie below 2% in 2009)
- ECB has also injected ample liquidity, widened its collateral framework, expanded its policy corridor (now withdrawn)
- Currently, ECB seems reluctant to go down "too low, too fast". However, given the fragile state of the economy, we think ECB would have no choice but to go lower. We look for rates to bottom at 1.5% by Q2'09, with a downward bias
- While difficult to entirely rule out QE, ECB is unlikely to resort to it, given the operational difficulties associated with it (which government bonds to buy etc)

ICICI Bank Corporate Solutions

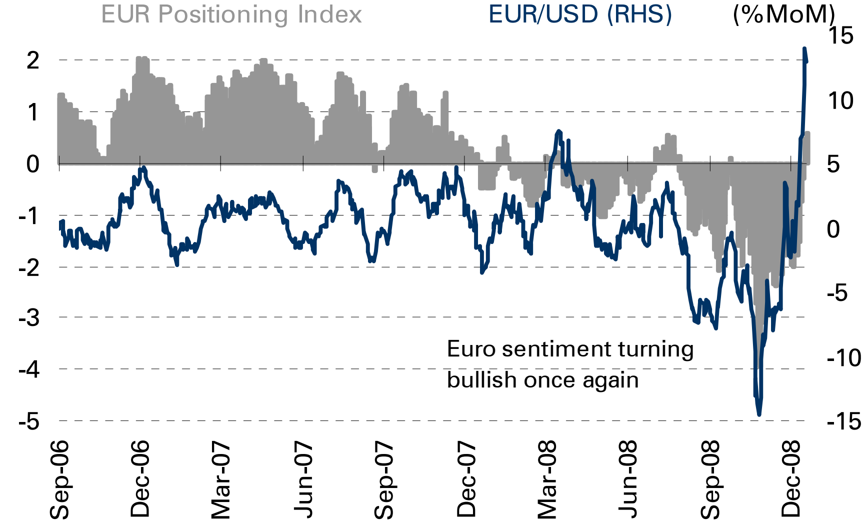
Divergence in policy action to support Euro

Euro performance has been mixed this year, more so post September



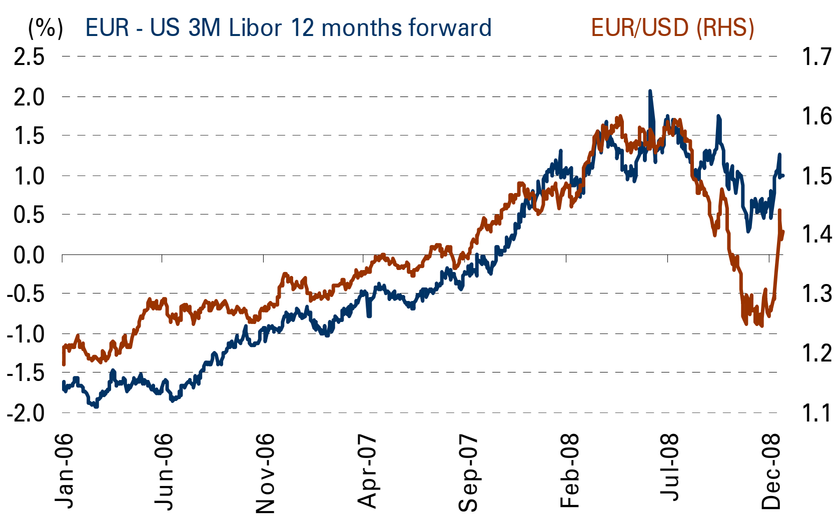
Source: Bloomberg, ICICI Bank Research

Our positioning index shows that the Euro might have bottomed out



Source: Bloomberg, ICICI Bank Research

Expected interest rate differentials could be Euro positive in the coming year



Source: Bloomberg, ICICI Bank Research

FX Outlook

- In the near term, dollar could see some appreciation supported by further announcement of policy measures, presence of event risks etc. However, it is unlikely to hold on to these gains in the long run as a move towards QE by the Fed would bring the dollar under pressure
- Moreover, since QE by ECB looks unlikely and even if ECB rates were to go down below the current expectations, the interest rate differential would still benefit Euro
- Mounting speculation that other central banks such as BoE, SNB would not only move towards ZIRP but could go for QE, should support Euro vs. its major crosses as well
- However, with many EZ members in a much bigger soup, competitive devaluation could be seen as a means to foster growth. This could undermine the Euro strength

UK

Risks of a prolonged recession loom large

Resilience likely to give way for steeper declines in consumer spending

Labor market weakening rapidly with growth outlook getting bleaker

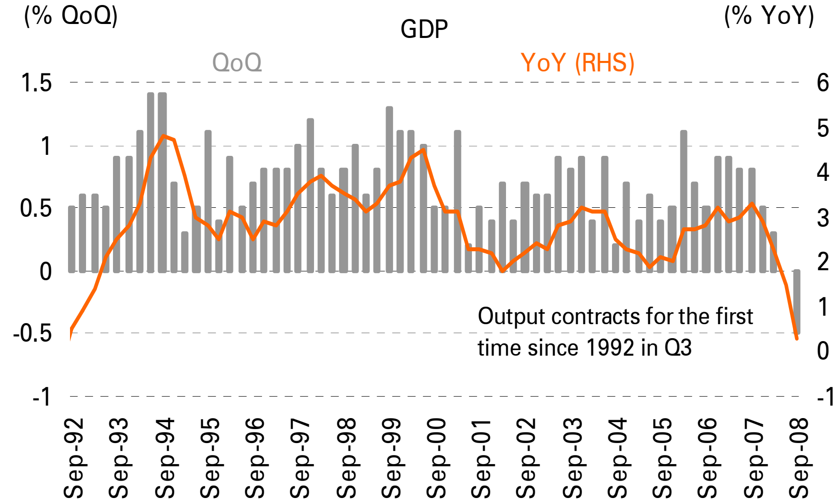
De-leveraging pressures char credit growth, tightens credit conditions

Housing set to slide more, magnifying deflation risks

Recessionary risks and deflationary fears demand more monetary easing

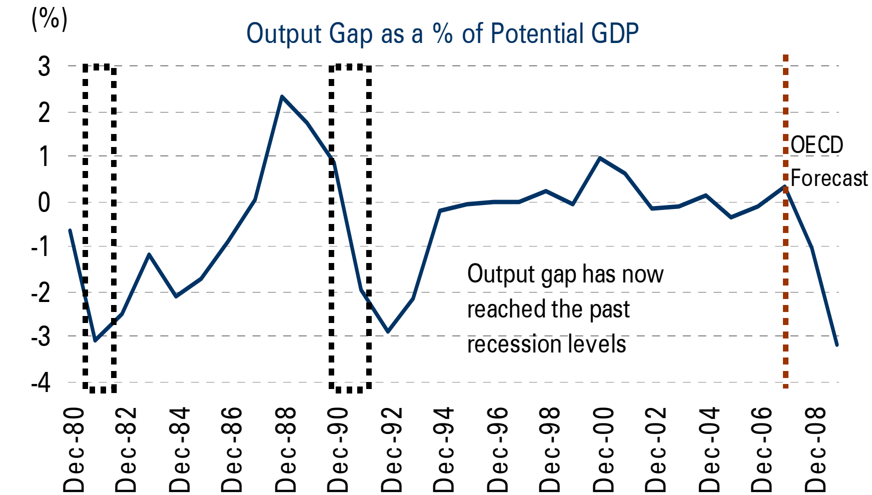
Risks of a prolonged recession loom large…

Growth has turned negative for the first time in 16 years…



Source: Bloomberg, ICICI Bank Research

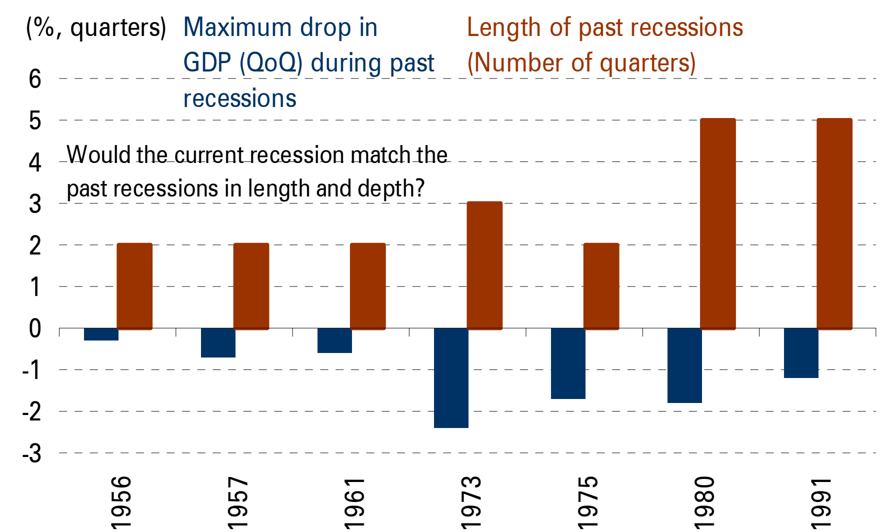
…and would pull down the output gap to the recessionary levels



Dotted box represents recession years

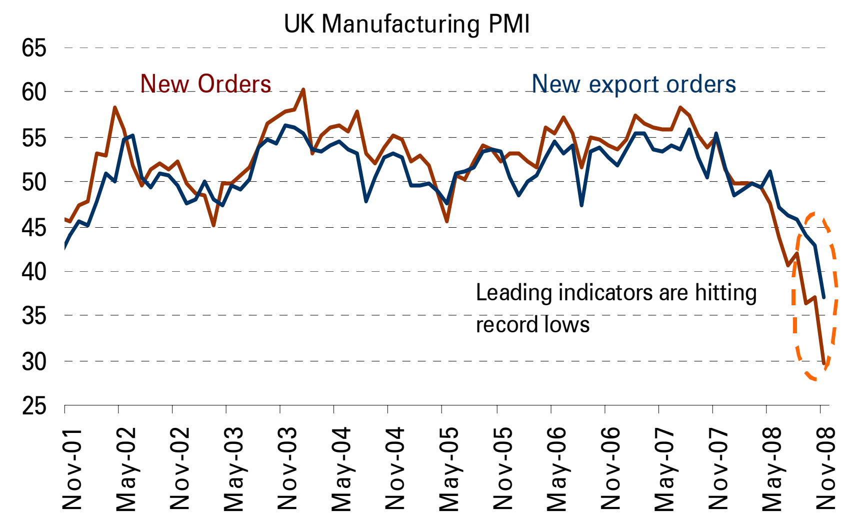
Source: Bloomberg, ICICI Bank Research

The current episode may turn out to be one of the most severe recessions…



Source: Bloomberg, ICICI Bank Research

as is suggested by leading indicators falling to record lows

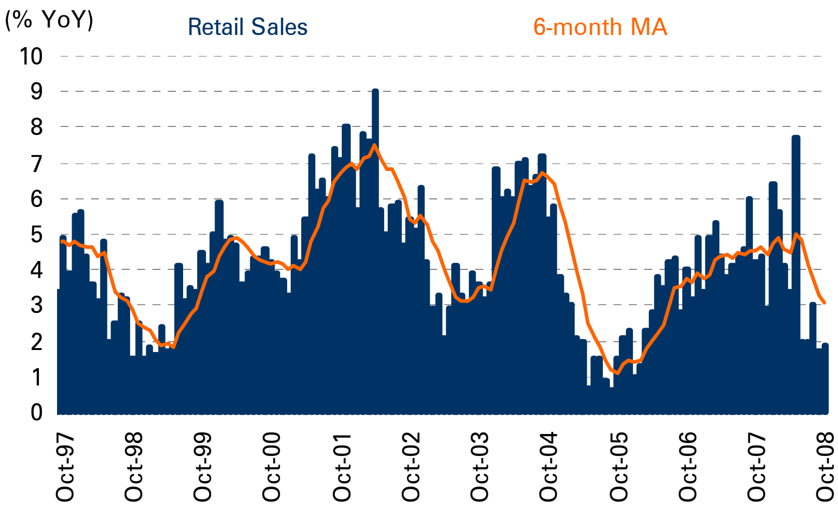


Source:Bloomberg, ICICI Bank Research

ICICI Bank Corporate Solutions

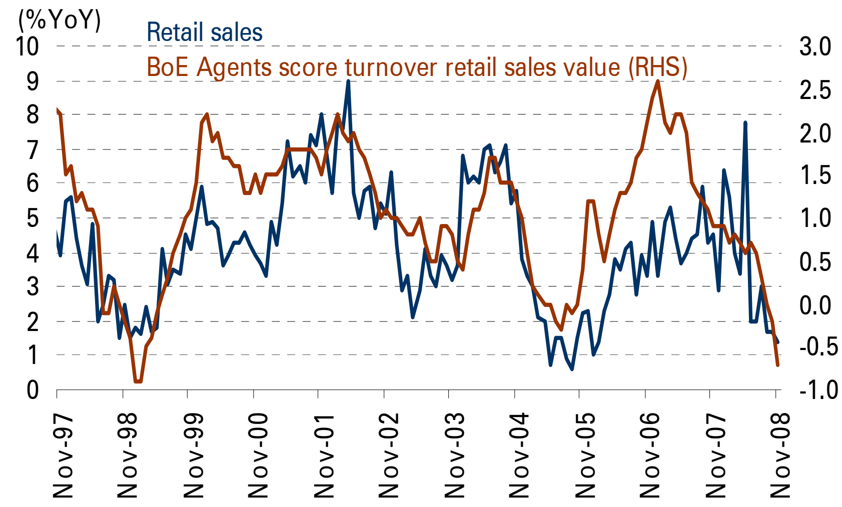
Resilience likely to give way to steeper declines in spending

Retail sales have started to wane…



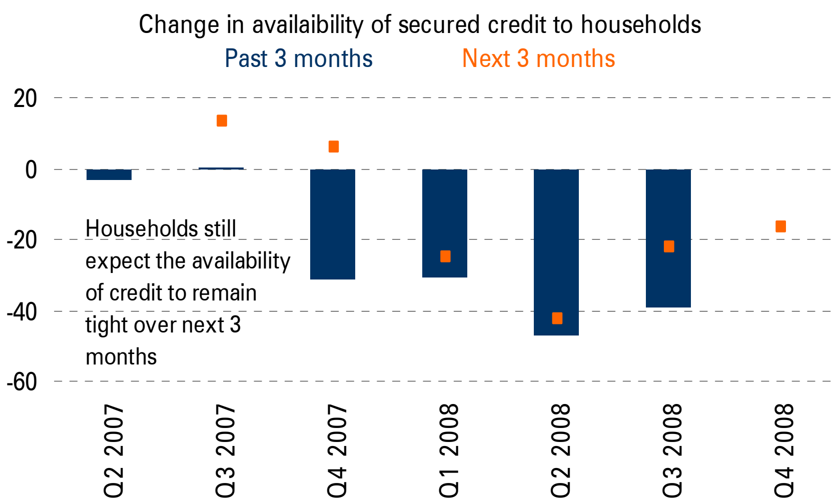
Source: Bloomberg, ICICI Bank Research

…but leading indicators hint at more downside to come



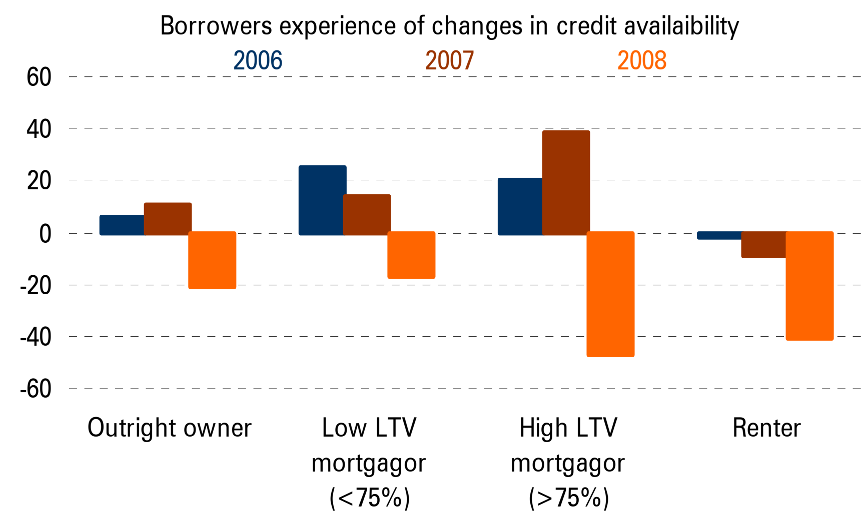
Source: Bloomberg, ICICI Bank Research

Tightening credit availability has weighed in on demand…



Source: BoE, ICICI Bank Research

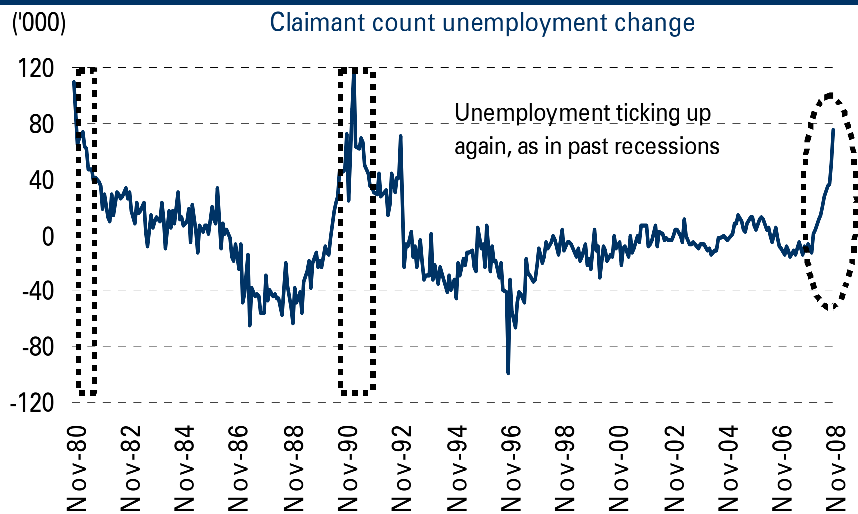
…with the higher risk categories suffering most acutely



Source:BoE, ICICI Bank Research

Labor market weakening rapidly as growth outlook worsens

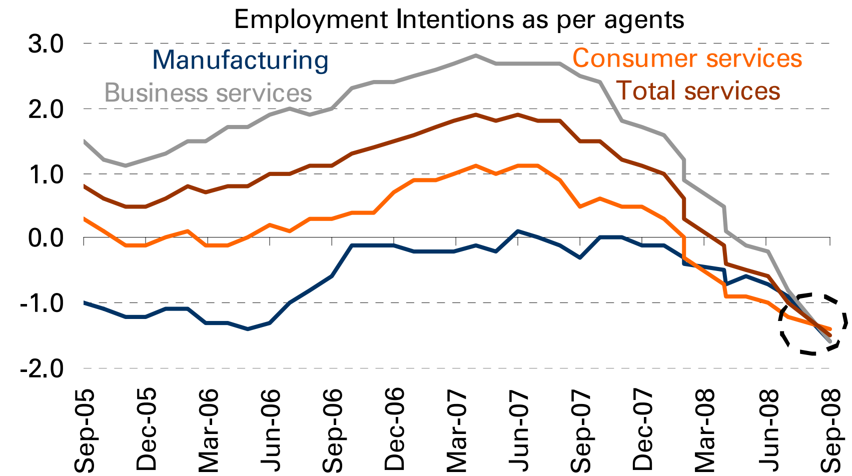
Unemployment rate is climbing up fast…



Dotted box represents recession period

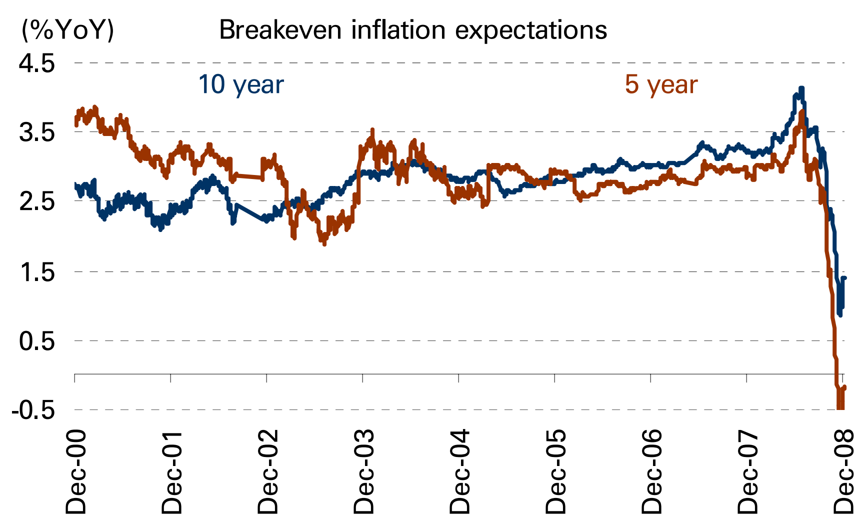
Source: Bloomberg, ICICI Bank Research

…with lead indicators hinting at more softening across sectors



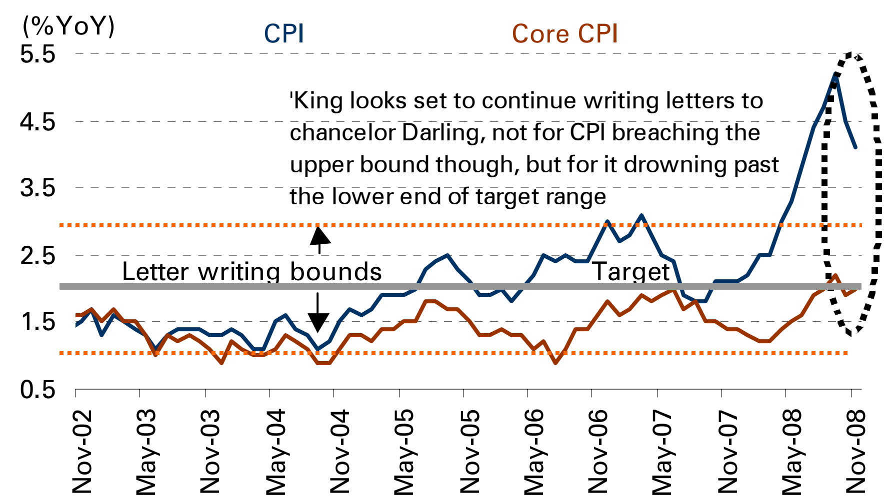
Source: BoE, ICICI Bank Research

While deflationary pressures can be hazardous to growth…



Source: Bloomberg, ICICI Bank Research

...moderation in prices is the only positive for consumption demand

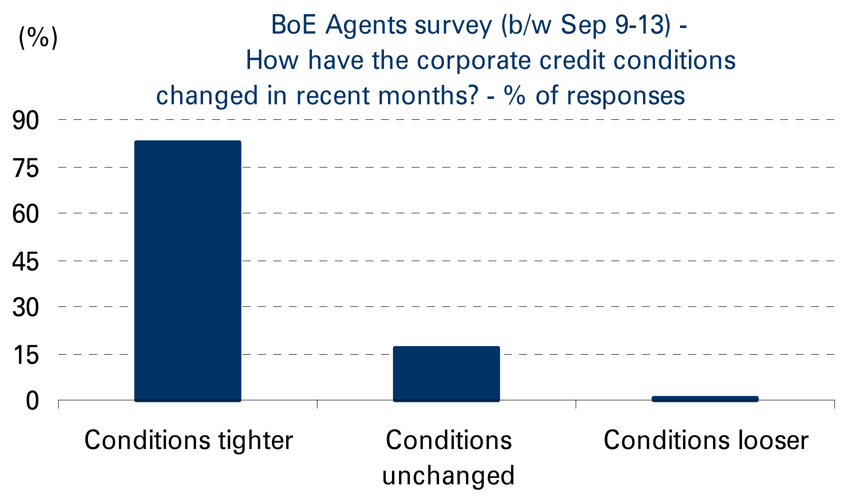


Source: Bloomberg, ICICI Bank Research

ICICI Bank Corporate Solutions

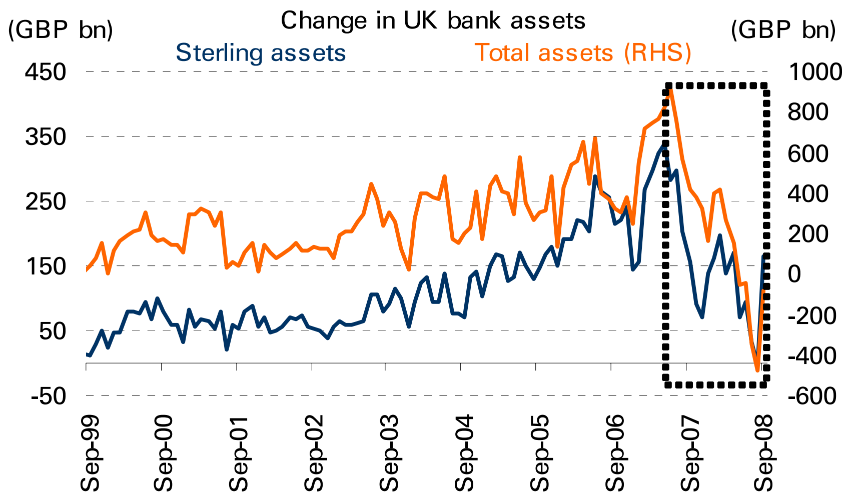
De-leveraging pressures charring credit growth

Corporations have also been facing tightening credit conditions…



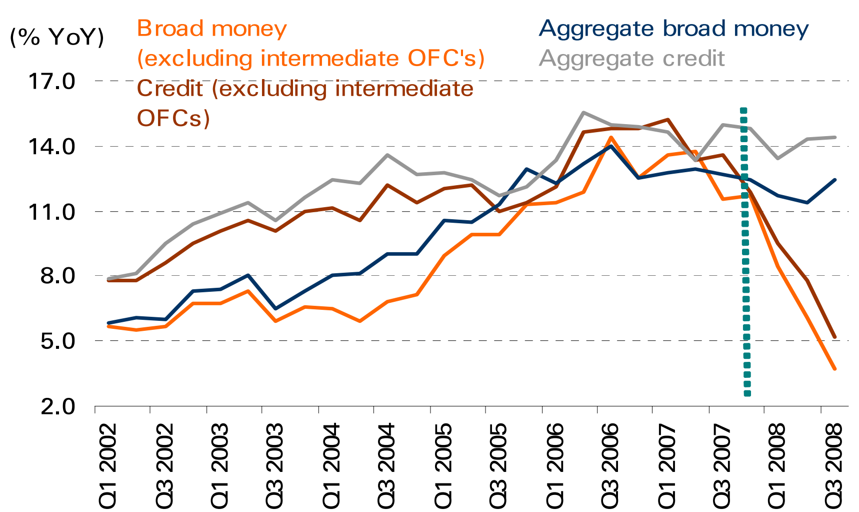
Source: BoE, ICICI Bank Research

…as banks cut back on asset growth to maintain capital adequacy



Source: BoE, ICICI Bank Research

Robust growth in aggregate credit may be misleading indicator and…



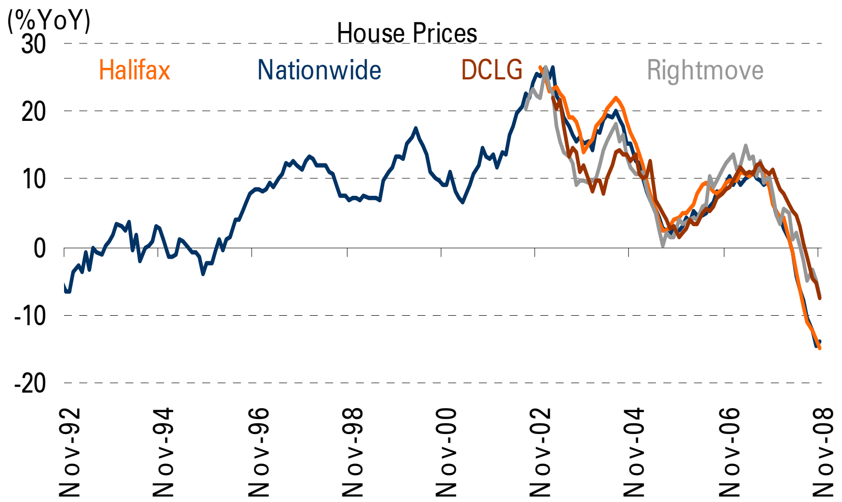
Source: BoE, ICICI Bank Research

…spells trouble for consumer spending and capital investments outlook

- Intensification of turmoil in the credit markets has forced the banks to de-leverage by securing injections of new capital, reducing lending and by selling assets
- While GBP50bn of extra equity capital has been pumped in for UK banks to mitigate the adverse impact of these de-leveraging pressures, money and credit growth has slowed nonetheless. Robust headline credit growth measures conceal a much weaker picture once volatile transactions undertaken by non bank financial companies like pension funds are excluded.
- Fiscal easing totaling GBP22bn, equivalent to 1% of GDP has also been announced to spur consumption, half of it reflecting a temporary cut in VAT from 17.5% to 15%, to last until 2010

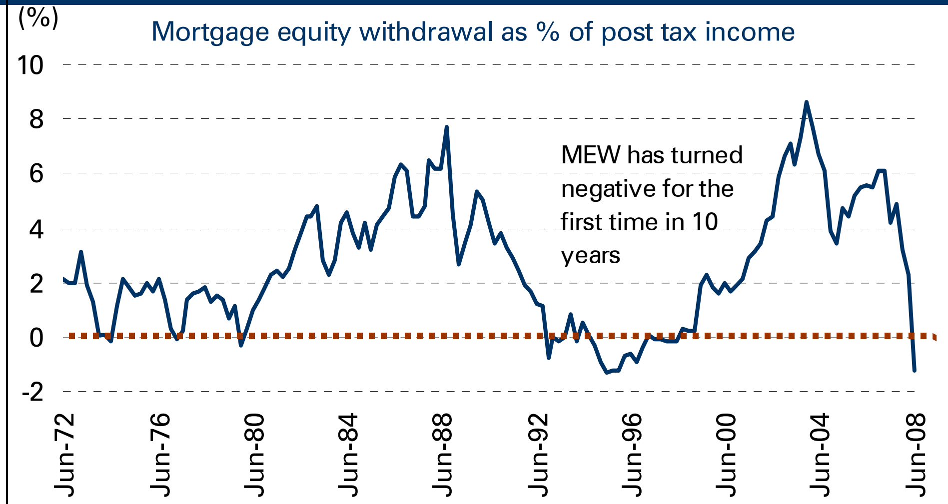
Housing set to slide more, magnifying deflation risks

House prices have entered the negative territory…



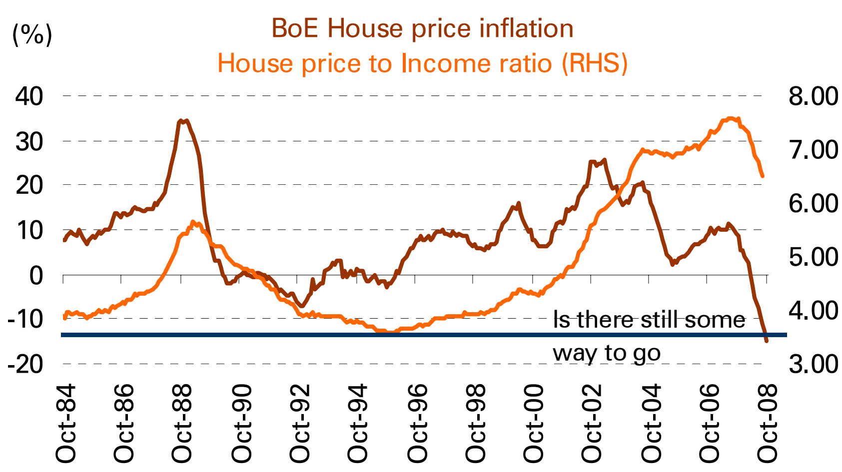
Source: Bloomberg, ICICI Bank Research

…forcing down MEW to the recessionary levels



Source: Bloomberg, ICICI Bank Research

..but the affordability is still expensive by historical comparisons



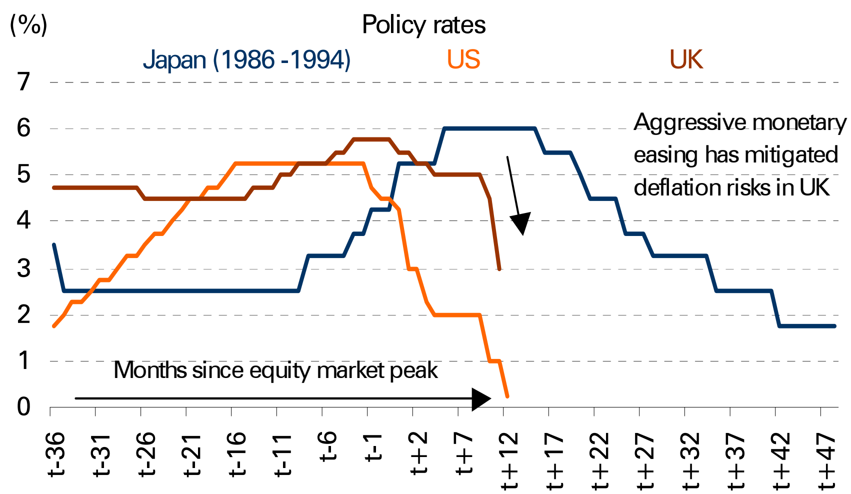
Source: BoE, ICICI Bank Research

More downside thus likely in medium term before stabilization occurs

- Declining property prices have been at the epicenter of the prevailing credit crisis with bank assets having been secured against the residential and commercial buildings
- Reduction in the value of collateral held was cited as a key reason by banks for reducing the availability of credit in the Q3 credit conditions survey
- Residential property prices have dropped 15% in the year to October, while in terms of affordability, prices are at the lowest levels in more than 4 years
- It would be imperative for authorities to pull the economy out of this vicious spiral of falling house prices, waning collateral values and restriction in availability of credit, which again lowers property prices. Nevertheless, more drop looks likely before property transactions tick up, and house prices bottom out

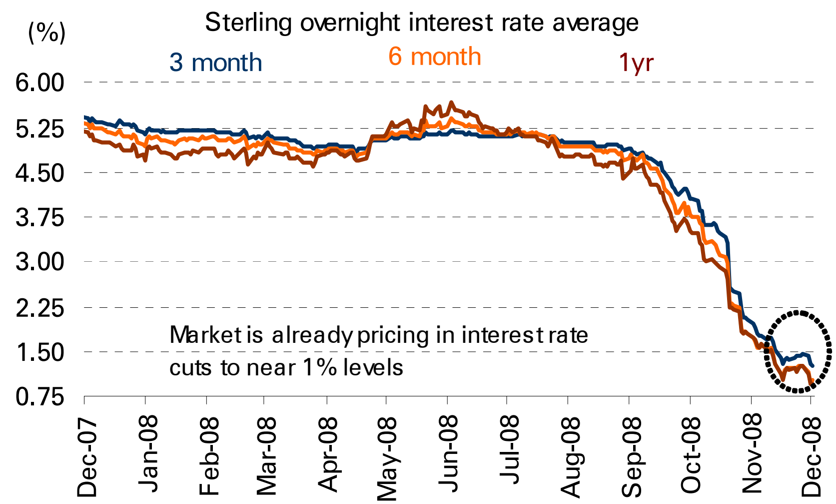
Recession risks & deflation fears demand more easing

BoE seems to have learnt lessons from the past deflationary episodes



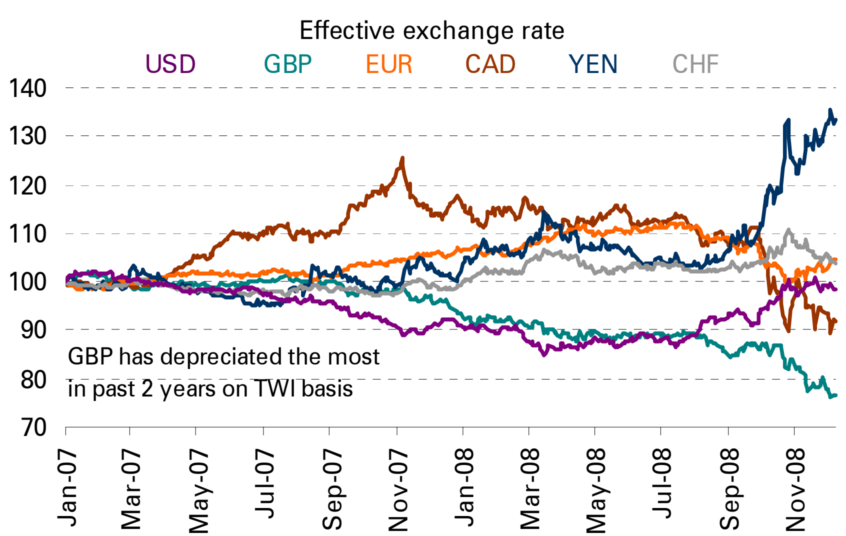
Source: Bloomberg, ICICI Bank Research

…but more cuts are in queue as the central bank tries to re-energize growth



Source: Bloomberg, ICICI Bank Research

Sterling moves, a function of risk aversion and yield differentials



Source: Bloomberg, ICICI Bank Research

Policy and FX outlook

- BoE policy rates, which already stand at lowest since records began in 1694, are poised to go down much below. As deflationary worries pick up with asset prices continuing to fall amidst declining commodity prices and slowing economy, BoE appears set to ease rates to sub 1% levels
- While fundamentals of sterling remain weak, it already is the worst performer since the onset of credit crisis. Even on a TWI basis, the currency has lost an enormous 27% in the last 18 months. This is one factor that would weigh in heavily on upcoming BoE rate decisions
- A weaker greenback would help sterling find a floor, but any upside appears limited in medium term. Only as the house prices stabilize in the second half of 2009, would a quicker sustained move up be seen

Japan

Growth mired in cyclical and global headwinds

Labor market slackening under weak growth conditions

Depleting corporate profitability to weigh on capex plans

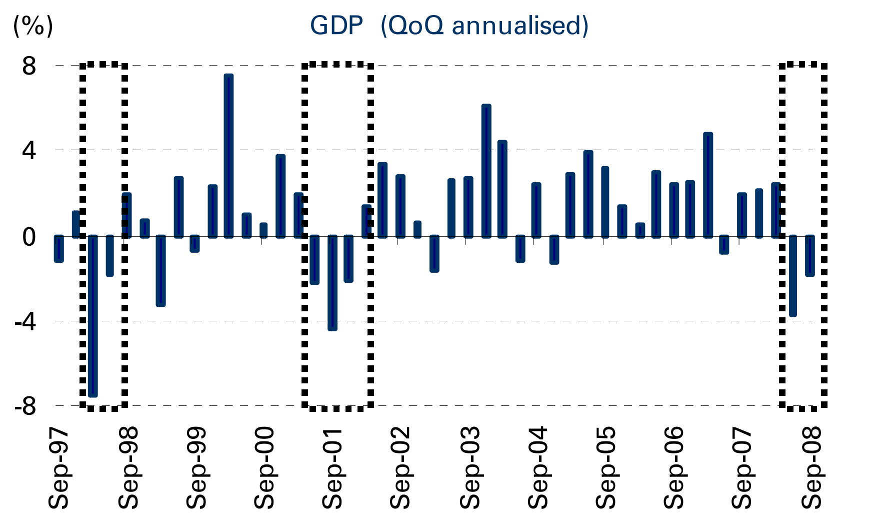
Falling prices bringing along the spectre of deflation

Return of monetary easing to tackle deflation and money market stresses

Yen strength on the back of continued risk aversion, a key concern for BoJ

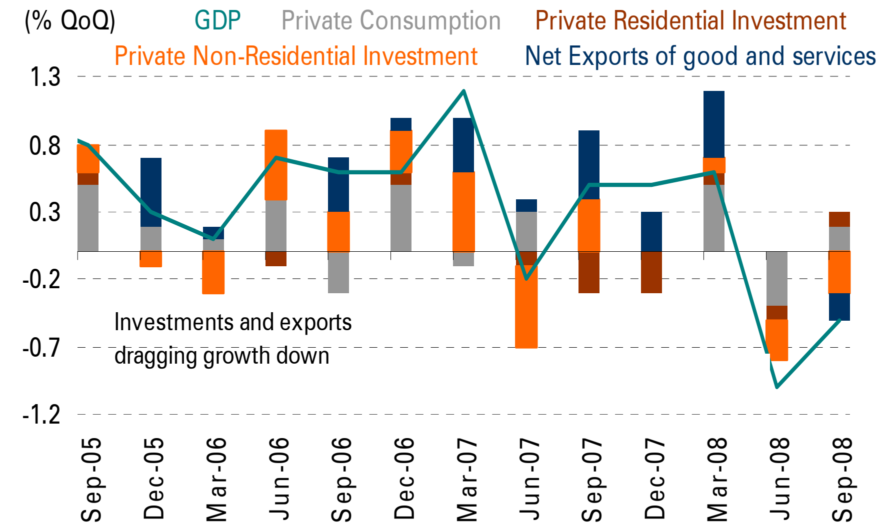
Growth mired in cyclical and global headwinds

Japan has entered a "technical recession" after 7 years….



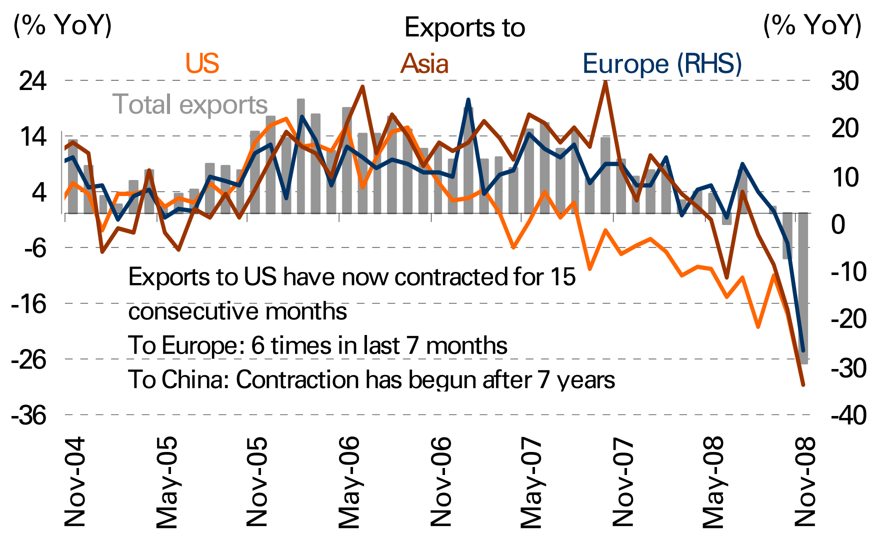
Source: Bloomberg, ICICI Bank Research

…as headwinds enclose the economy from all corners



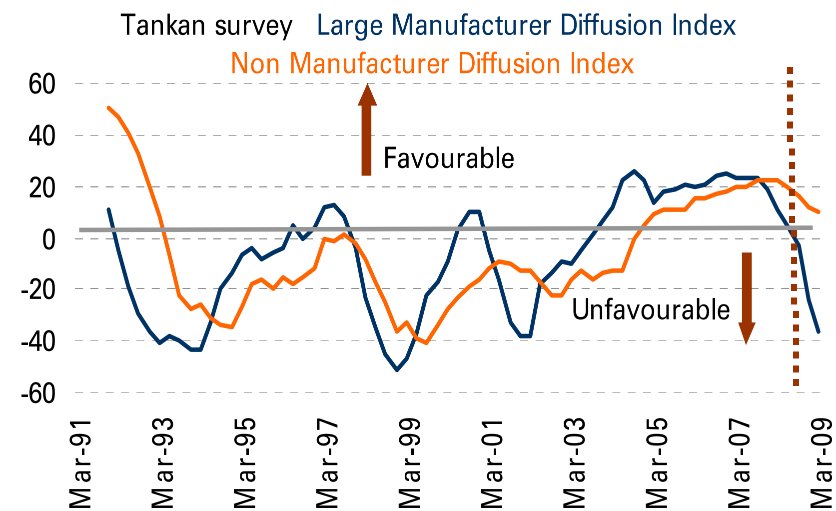
Source: Japan MoF, ICICI Bank Research

Exports have been severely hit from slowing growth in key trade partners



Source: Bloomberg, ICICI Bank Research

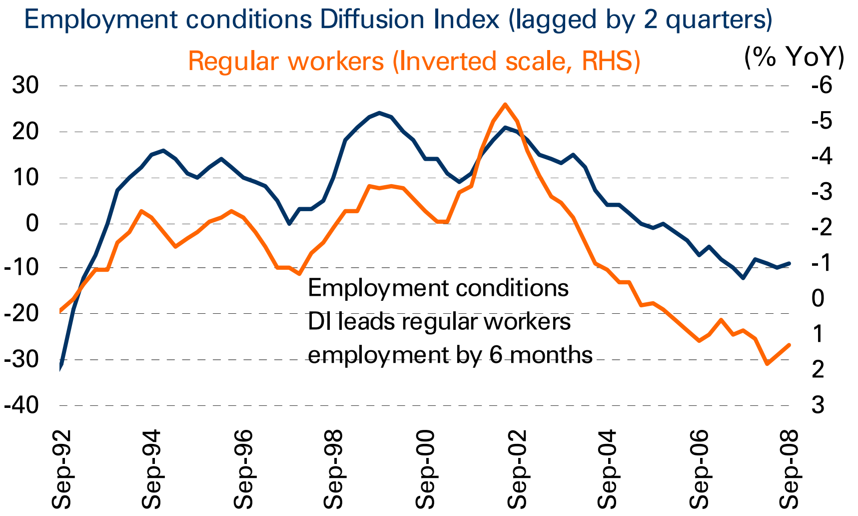
…pulling down the business sentiment to record lows



Source: Bloomberg, ICICI Bank Research

Labor markets slackening under weak growth conditions

Labor markets have continued to loosen...

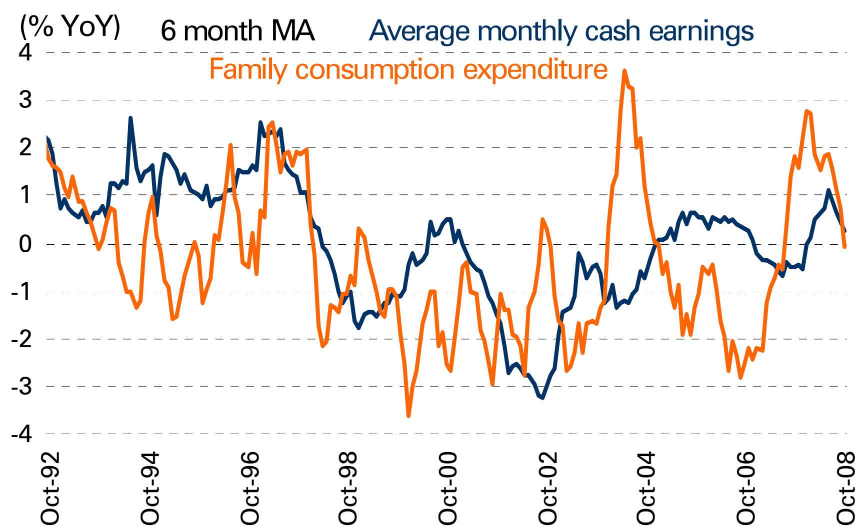


Source: Bloomberg, ICICI Bank Research

...with leading indicators suggesting at further easing

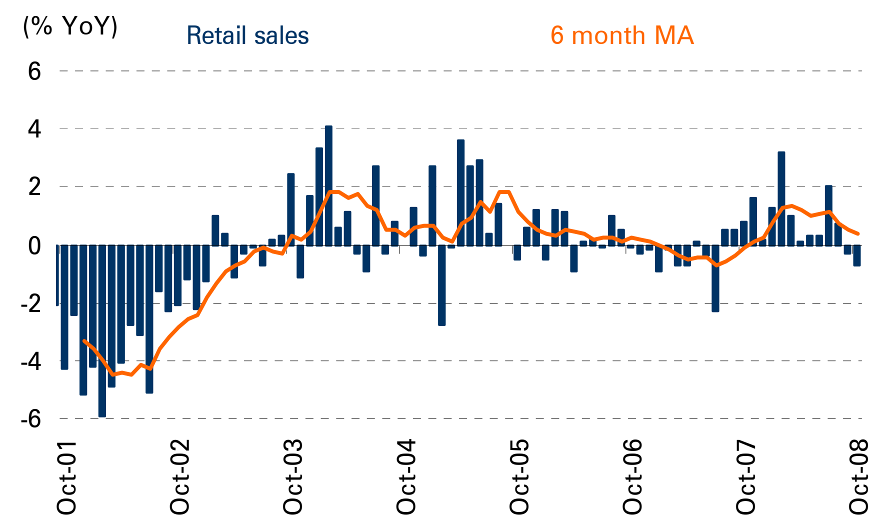
Dotted box represents recession period
Source: Reuters Ecowin, ICICI Bank Research

Wage growth would remain tepid, weigh on domestic consumption



Source: Reuters Ecowin, ICICI Bank Research

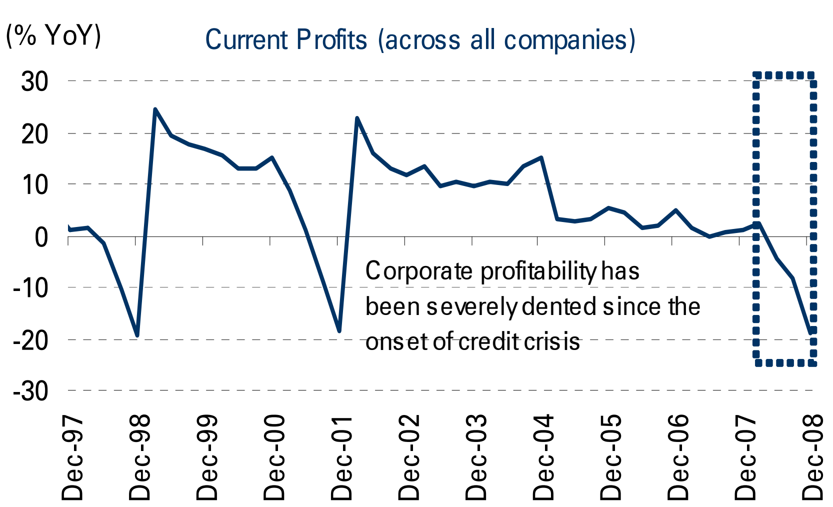
...as is already perceptible in retail sales numbers that have turned negative



Source: Bloomberg, ICICI Bank Research

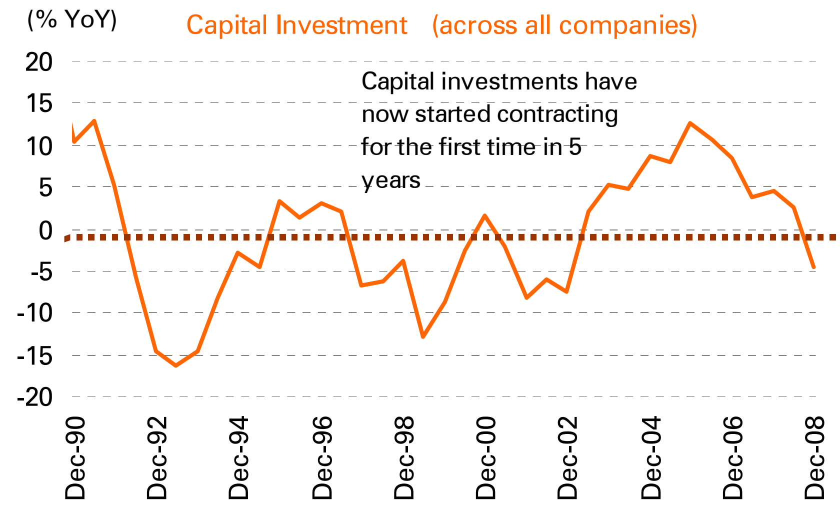
Depleting corporate profitability to weigh on capex plans

Waning export growth has weighed in on corporate profitability…



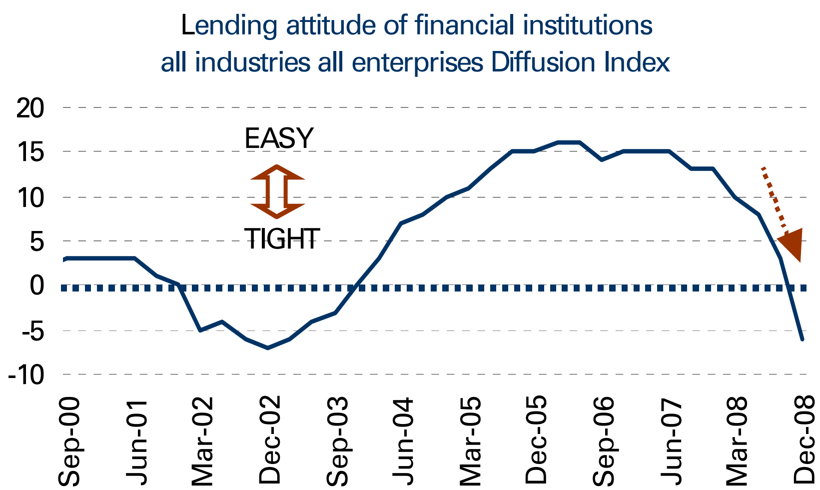
Source: Reuters Ecowin, ICICI Bank Research

..dismantling or deferring any prior capital expenditure plans of corporations



Source: Reuters Ecowin, ICICI Bank Research

Tightening lending standards have added fuel to fire…



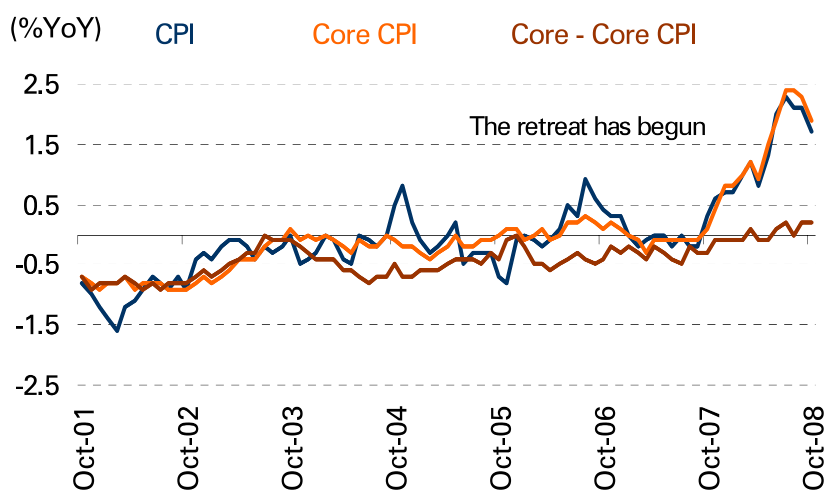
Source: Reuters Ecowin, ICICI Bank Research

…as economy struggles to tread forward yet again

- Waning export growth and softening domestic demand has weighed in on corporate profitability, and catapulted expansion plans out of sight
- According to business plans in latest Tankan survey, the current profits are expected to drop for the second straight year in fiscal year 2008
- Overseas machine orders, a lead indicator for capital goods exports (that contribute roughly 50% to shipments), have been declining sharply, hinting at severe headwinds shrouding outlook for exports and capital expenditures.
- Financial institutions have also tightened their lending standards, darkening the growth projections. The conditions for CP issuances too worsened sharply in the latest Tankan survey, highlighting the funding pressures

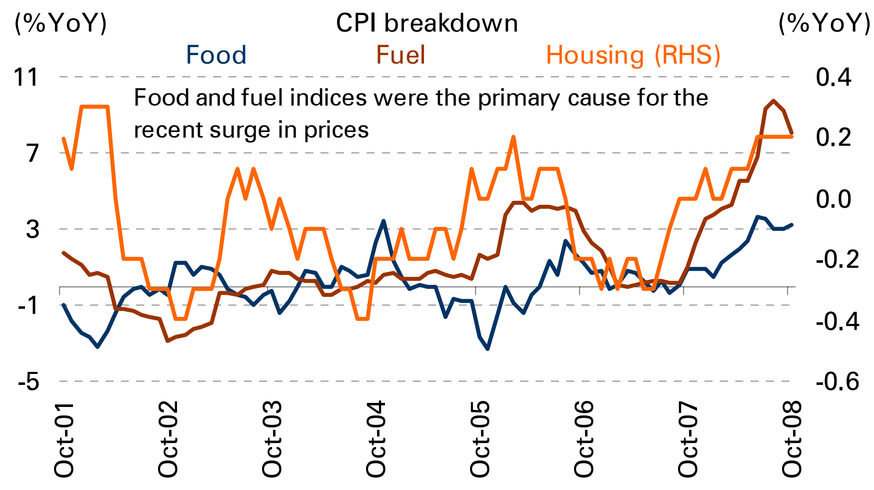
Falling prices bringing along the spectre of deflation

Supply driven inflation pressures on the ease…



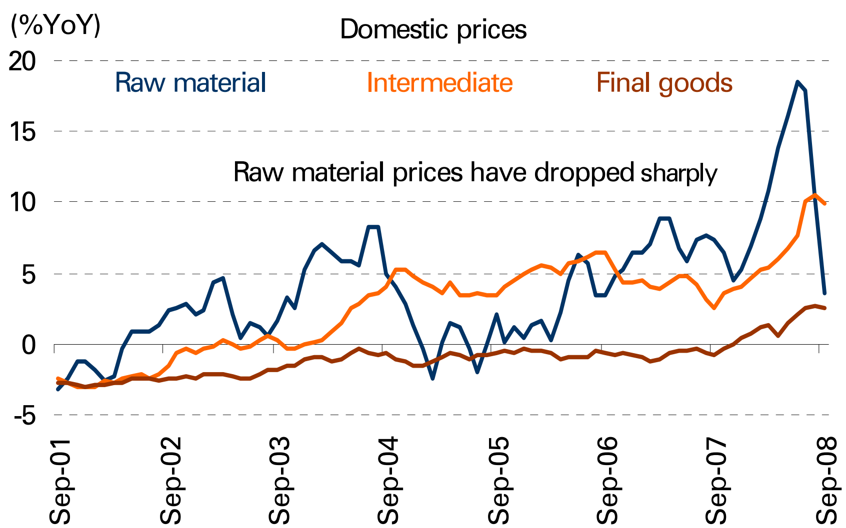
Source: Bloomberg, ICICI Bank Research

…as commodity cycle reverses



Source: Bloomberg, ICICI Bank Research

Sharp drop in raw material prices, a harbinger of future price declines



Source: Bloomberg, ICICI Bank Research

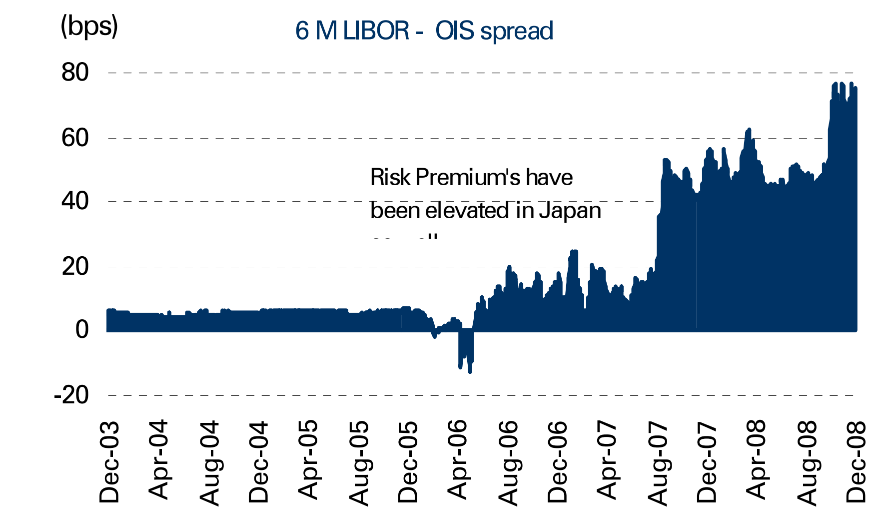
Long term inflation expectations are in fact hinting at deflation pressures

Source: BoJ, ICICI Bank Research

ICICI Bank Corporate Solutions

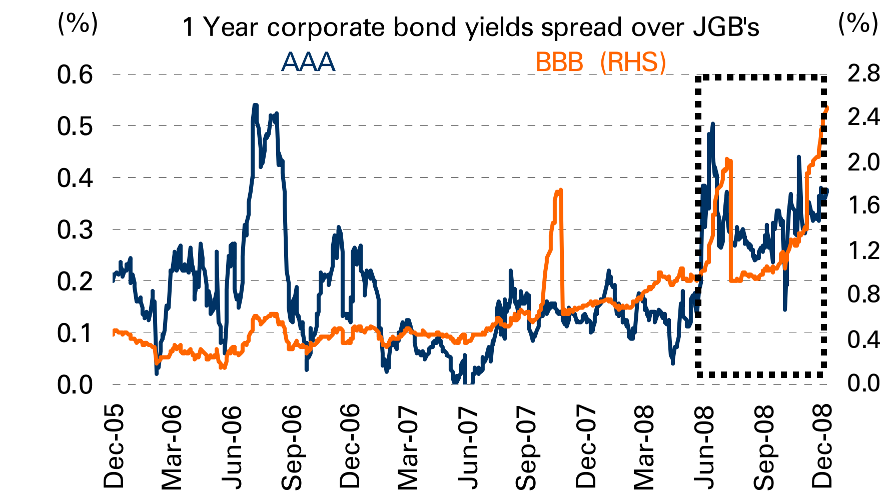
Japan not immune from money market stress

Conditions have remained stressed in the money markets….



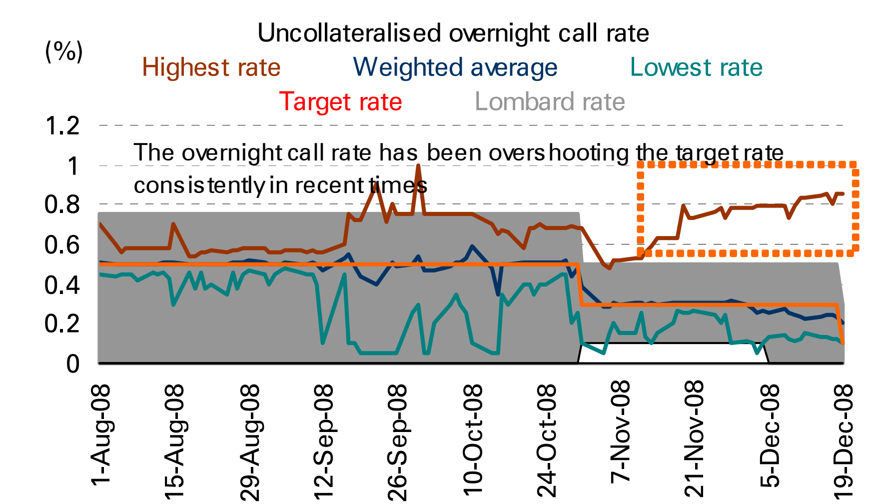
Source: Bloomberg, ICICI Bank Research

…and has brought about the recent spikes in corporate bond yields



Source: CEIC, ICICI Bank Research

BoJ was thus forced to prune rates to near the nominal zero bound…



Source: BoJ, ICICI Bank Research

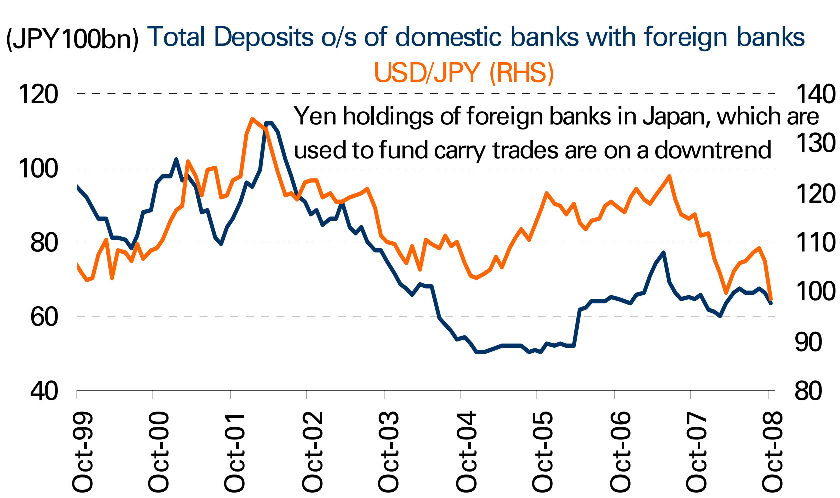
…to revive growth as deflationary worries gain steam again

- BoJ has substantially revised its earlier growth projections of 1.2% and 1.5% for FY08 and FY09 respectively, to around 0% and 0.5%, with growth expected to revert to potential (1.5%) in 2010
- As international commodity prices cool off, Japan which imports most of its demand, has started to witness falling prices. Coupled with a slowing economy, this has again raised fears of a return of deflation. The latest government forecasts confirm such worries and project CPI to fall 0.4% in the next fiscal year, while the corporate goods price index is expected to contract 2.1% in the corresponding period
- Equities sell-off, yen upswing and tighter financing conditions due to stresses in funding markets have compounded BoJ's problems

ICICI Bank Corporate Solutions

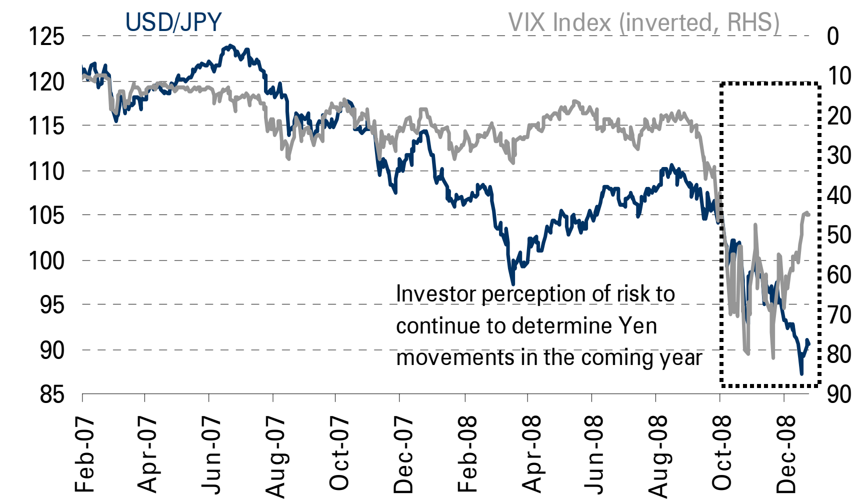
Yen's gains on continued risk aversion, a concern for BoJ

Carry activity poised to stay tepid…



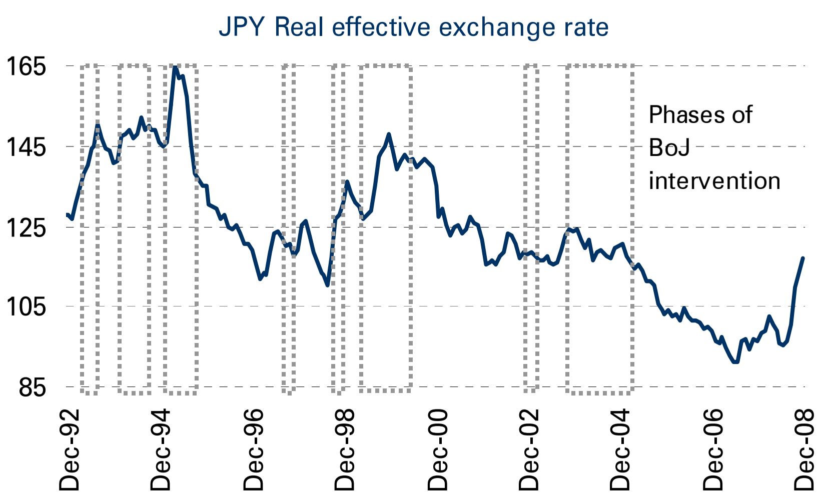
Source: BoJ, ICICI Bank Research

…as risk aversion stays high, thereby supporting JPY strength



Source: Bloomberg, ICICI Bank Research

BoJ thus likely to intervene in the currency markets to arrest the move



Source: Bloomberg, ICICI Bank Research

Significant expansion in BoJ balance sheet likely with rates close to zero

- Post the Fed's cling to quantitative easing, and a dismal Tankan, BoJ acted again, pruning rates to 0.1%, while also deciding to increase its outright JGB purchases to JPY1.4tn per month from 1.2tn earlier, forming grounds for quantitative easing. From hereon, with policy rates already close to the nominal zero bound, expansion in BoJ balance sheet looks imminent, as the central bank seeks to resolve money market stresses
- From Yen's perspective, lack of carry revival and repatriation of foreign bond investments would continue to shoulder currency's strength in medium term. However, any sharp move down is 'undesirable' and looks unlikely as it sparks 'intervention' prospects. We forecast a flattish trajectory for Yen into 2009, with unavoidable short term overshoots

ICICI Bank Corporate Solutions

Switzerland

Swiss economy all set to enter a recession next year

Global slowdown, financial dislocations put a break on economic activity

Economic downturn to feed into a softening labour market

Price stability well on its way

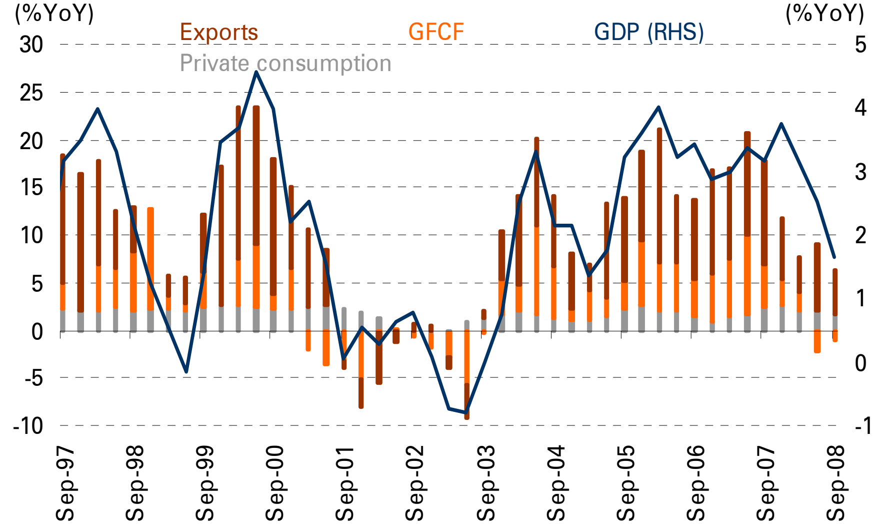
Risk aversion continues to haunt financial markets

SNB to remain ahead of the curve, continue with policy easing

Franc strength against Euro a concern for SNB

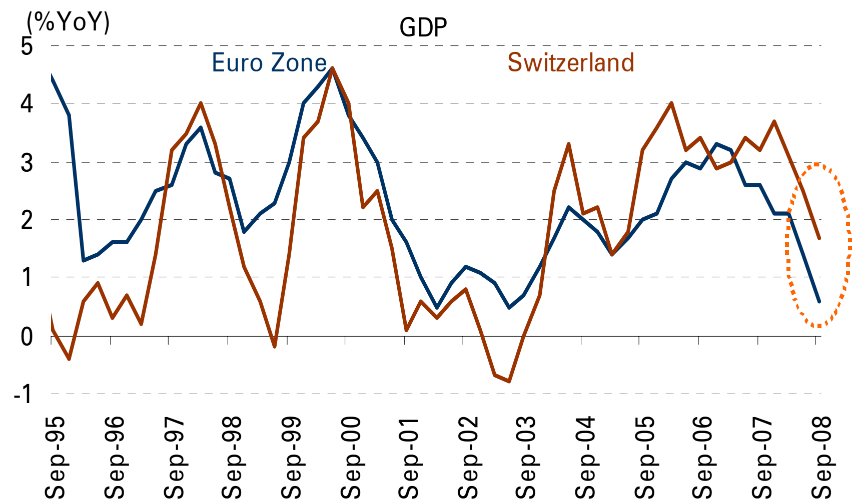
Swiss set to enter a recession next year as risks materializing

Economic downturn well under way and it could get further aggravated…



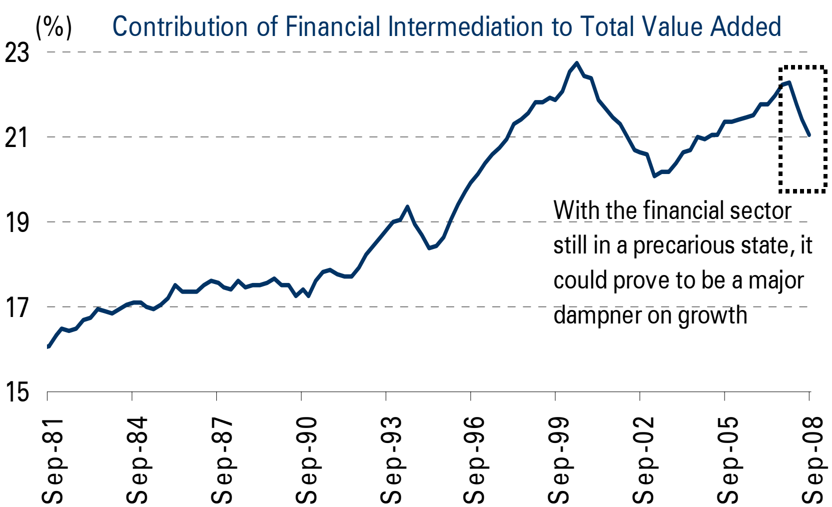
Source: Bloomberg, ICICI Bank Research

…by possibly a severe recession in its biggest trading partner i.e. EZ and



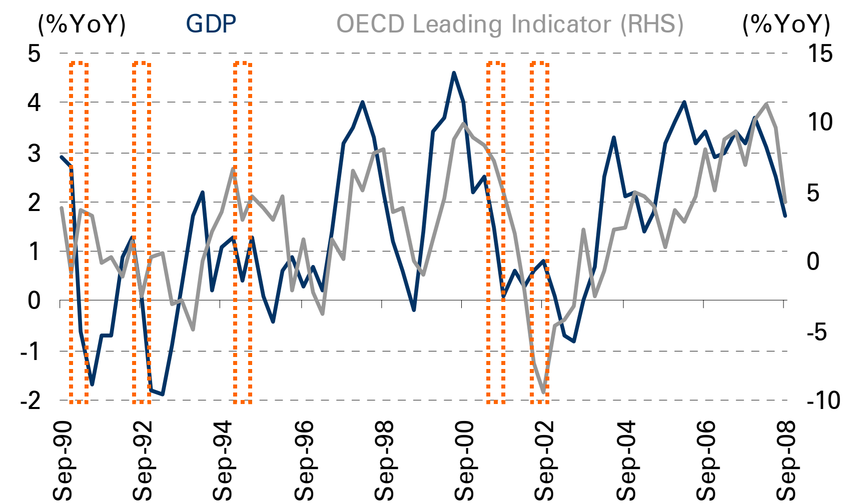
Source: Bloomberg, ICICI Bank Research

…an exceptionally high share of financial services to overall growth



Source: Reuters Ecowin, ICICI Bank Research

However, leading indicator yet to fall to levels seen during 2003 recession



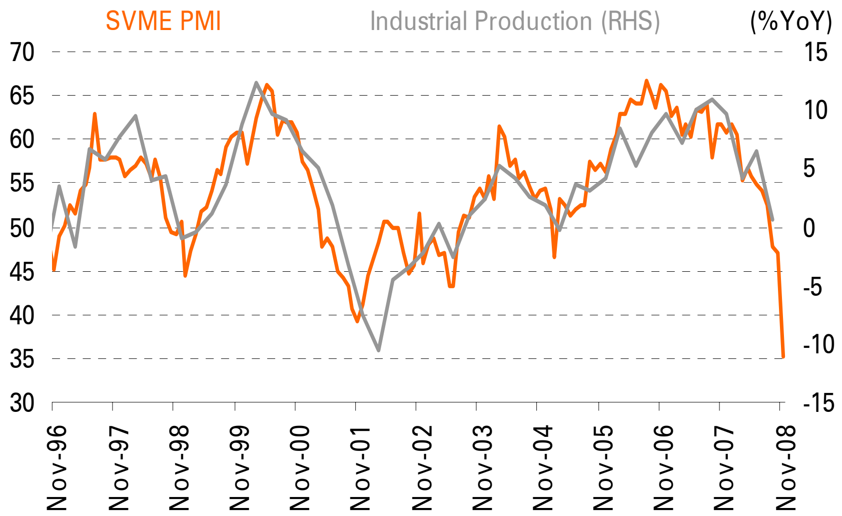
Dotted box represents recession period

Source: Bloomberg, ICICI Bank Research

ICICI Bank Corporate Solutions

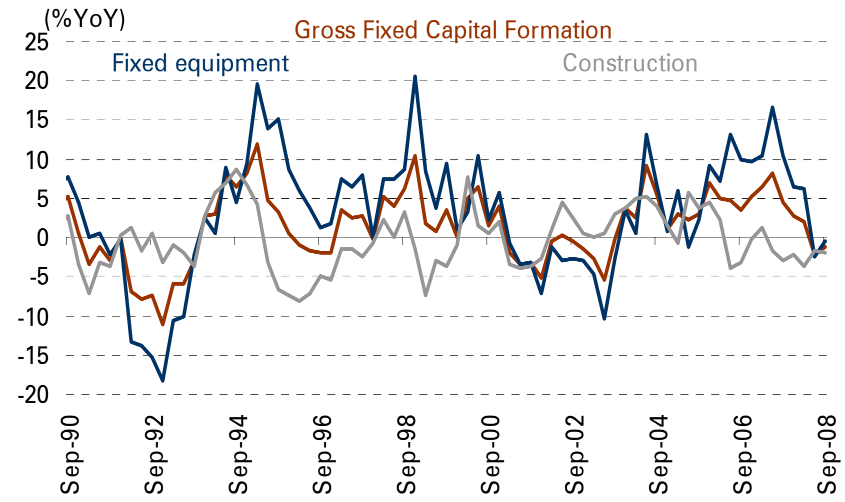
Global slowdown, financial dislocations put a break on activity

Decline in industrial activity likely to pick up pace in coming months



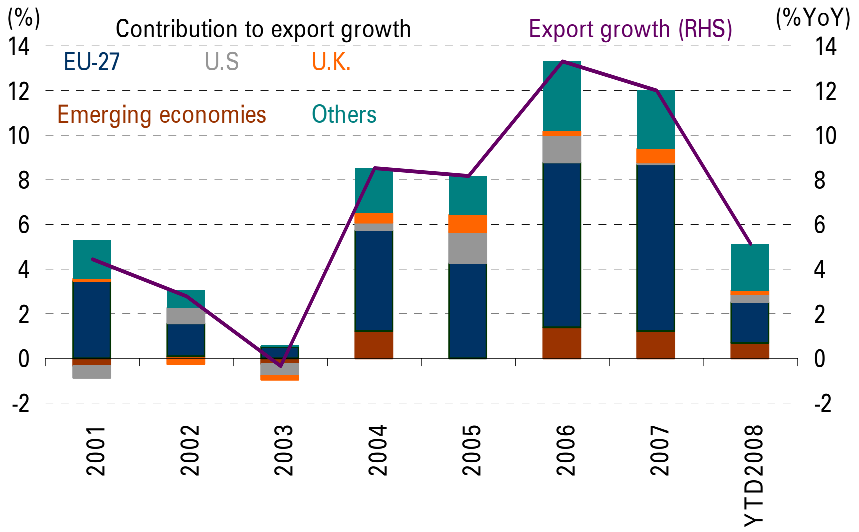
Source: Bloomberg, ICICI Bank Research

Investments plans to take a back seat as the economic woes deepen



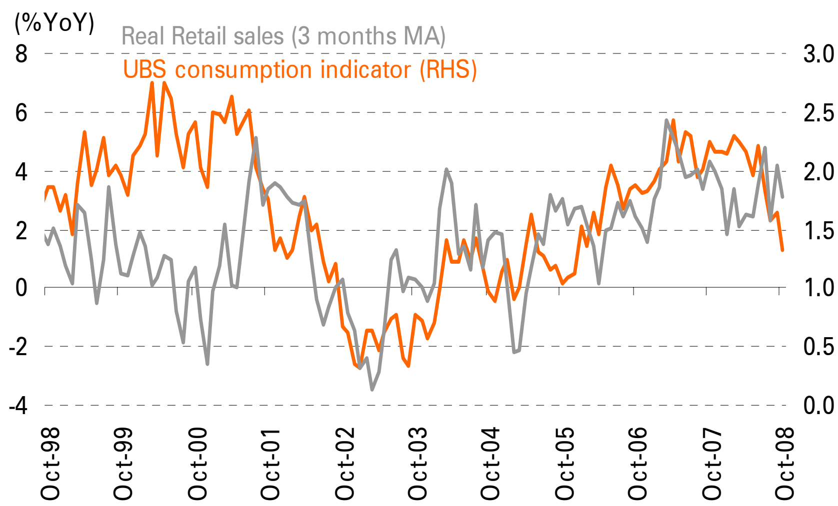
Source: Reuters Ecowin, ICICI Bank Research

With major trading partners amidst a severe recession, exports to take a hit



Source: Reuters Ecowin, ICICI Bank Research

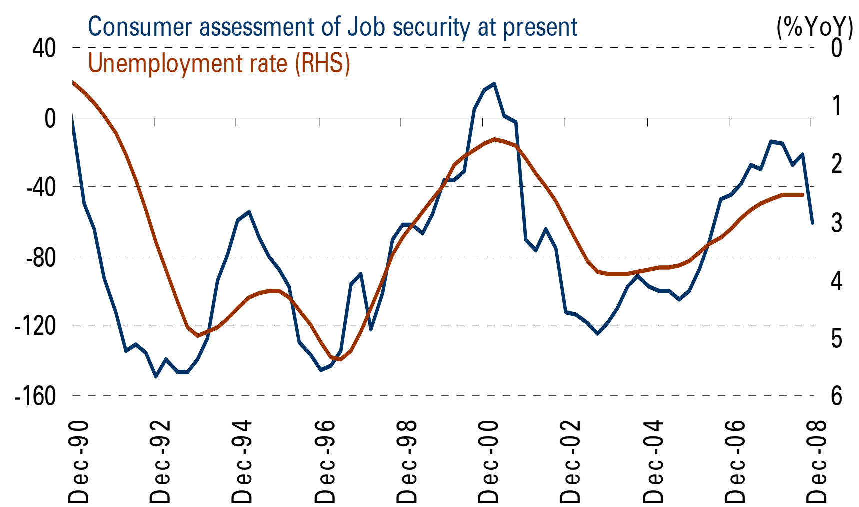
The only respite – consumption, which though moderating, is holding on



Source: Bloomberg, ICICI Bank Research

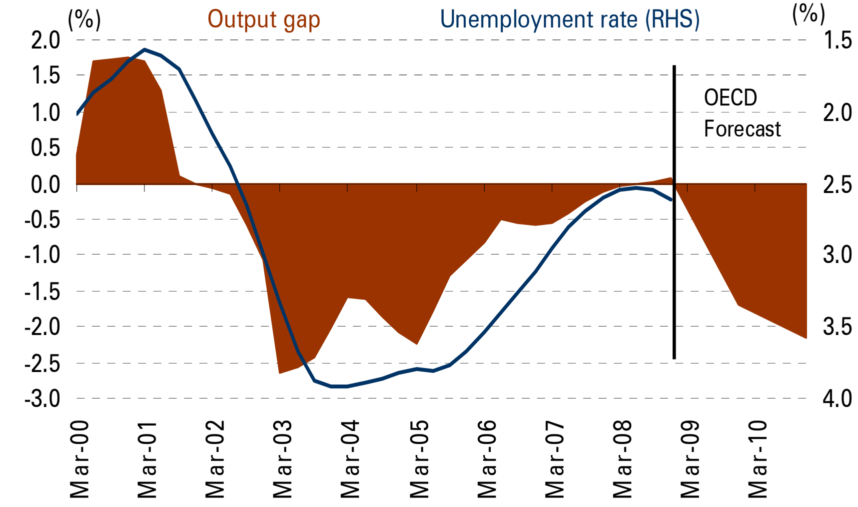
Labour market to soften, price stability well on its way

Job insecurity on the rise as companies likely to layoff workers to cope…



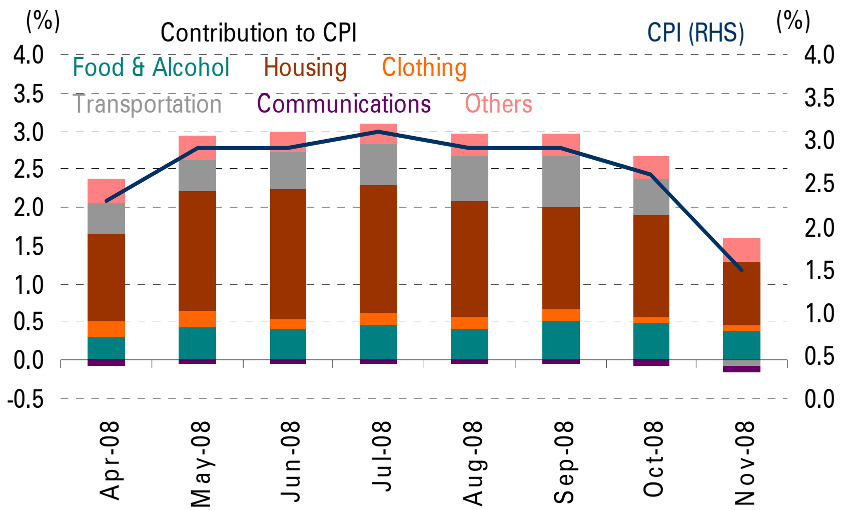
Source: Reuters Ecowin, ICICI Bank Research

…with economic downturn, causing the unemployment rate to move up



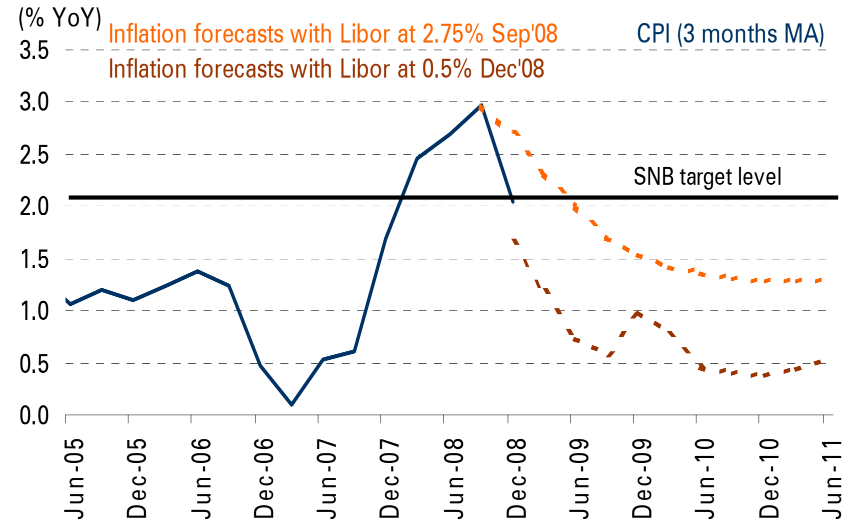
Source: Reuters Ecowin, ICICI Bank Research

With commodity prices virtually collapsing, inflation has fallen sharply



Source: Bloomberg, ICICI Bank Research

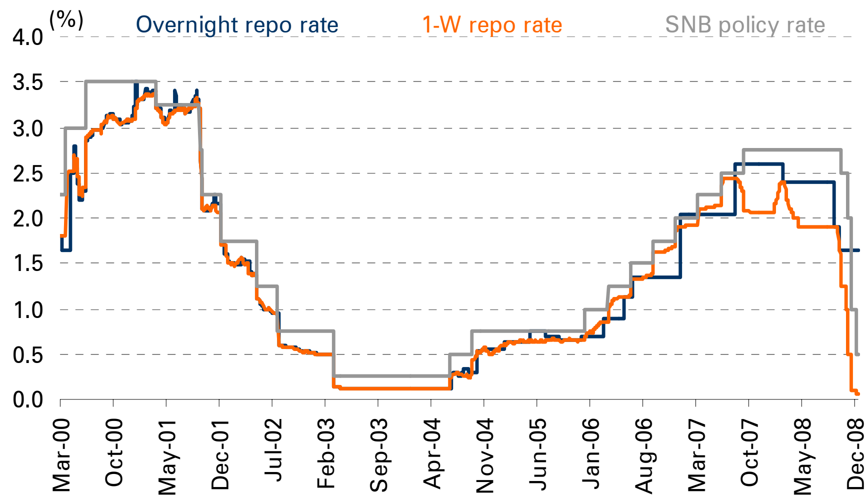
This together with the growth downturn will keep prices muted for long



Source: Bloomberg, SNB, ICICI Bank Research

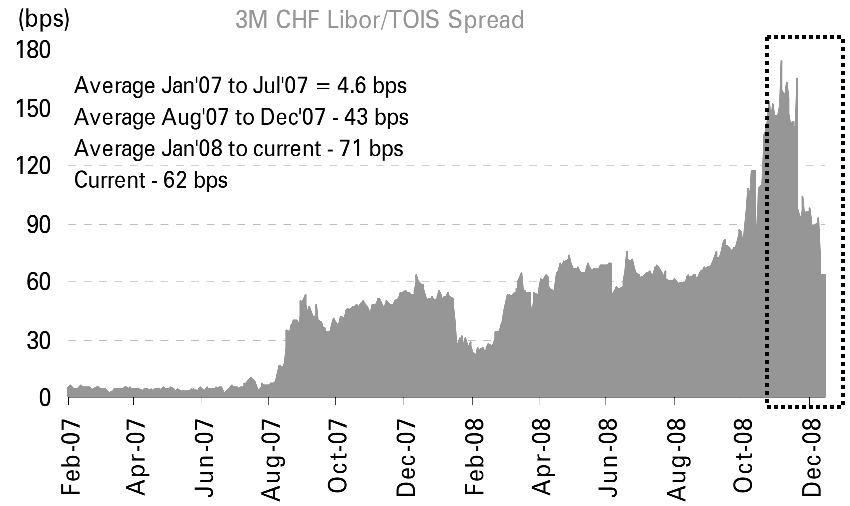
Risk aversion continues to haunt financial markets

While the massive liquidity injections & aggressive policy easing by SNB…



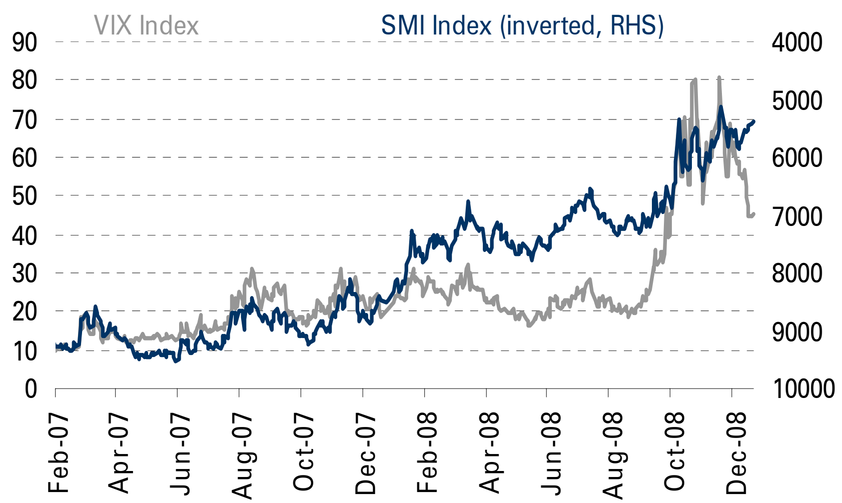
Source: Bloomberg, ICICI Bank Research

…have helped to improve financial conditions, risk premia is still elevated



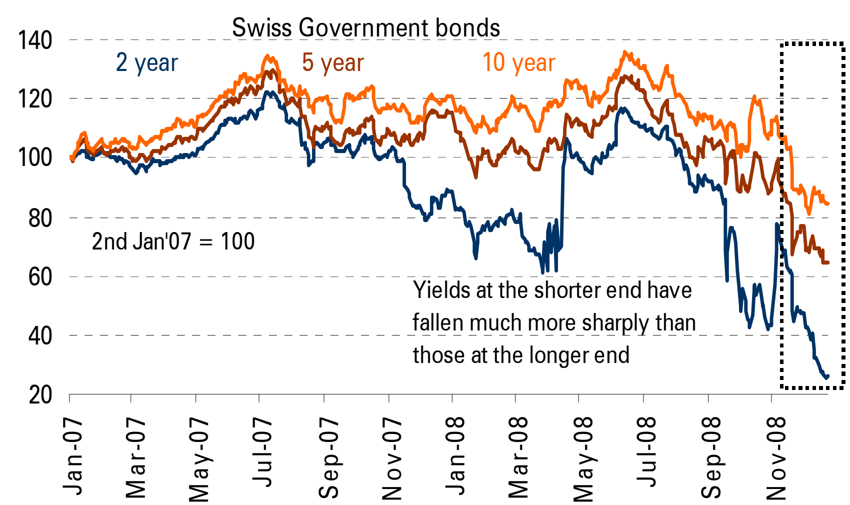
Source: Bloomberg, ICICI Bank Research

With risk aversion still abnormally high, equities continue with their…



Source: Bloomberg, ICICI Bank Research

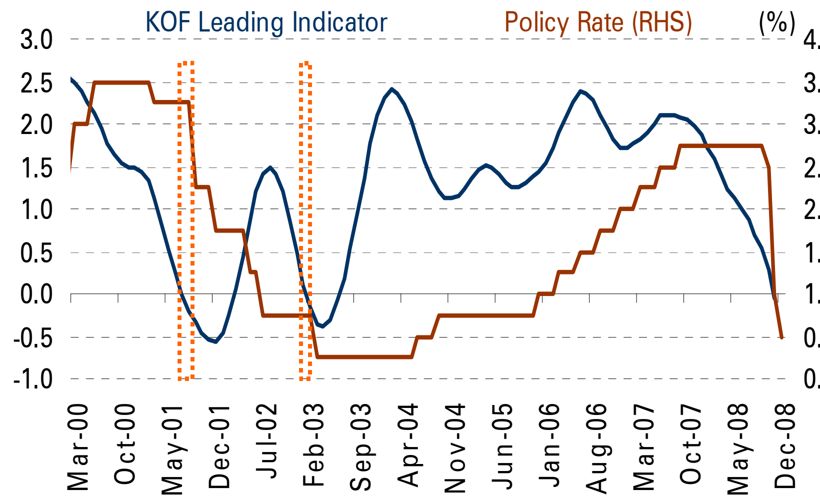
…downward slide as do yields, particularly those at the shorter end



Source: Bloomberg, ICICI Bank Research

SNB ahead of the curve, CHF strength against EUR a concern

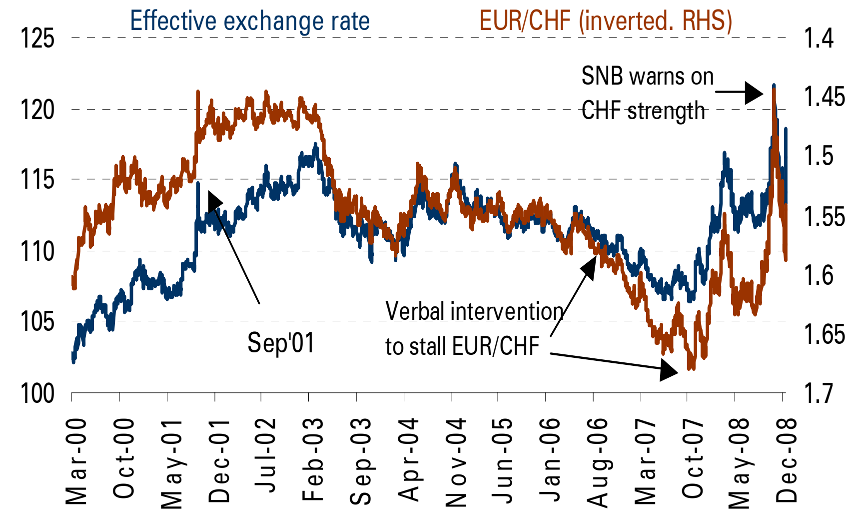
SNB nears towards ZIRP as growth worries have prompted aggressive…



Dotted boxes coincide with recession

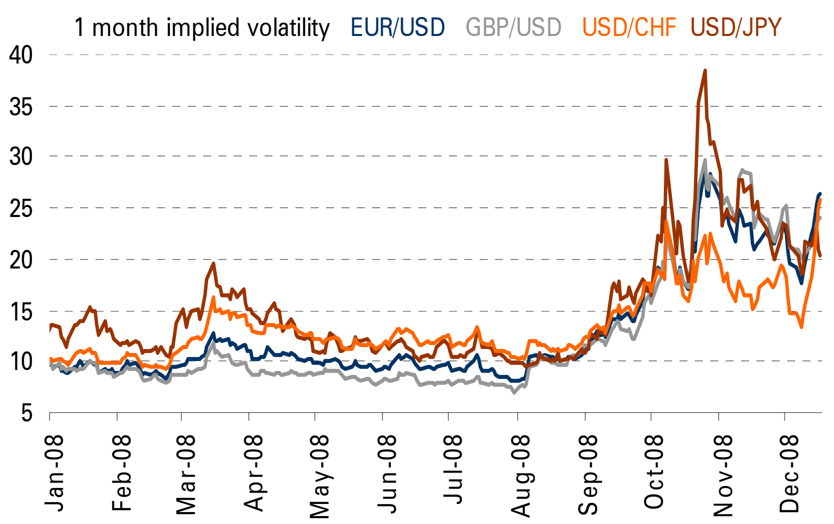
Source: Bloomberg, ICICI Bank Research

…SNB action, which has in turn fed into CHF weakness vis-à-vis EUR



Source: Bloomberg, ICICI Bank Research

CHF has been less volatile since the intensification of the crisis



Source: Bloomberg, ICICI Bank Research

FX and Monetary Policy Outlook

- To boost growth, Swiss government to bring forward CHF 1bn of planned spending in 2009
- The worsening domestic conditions (SNB forecasts growth at –0.5 to –1% in 2009) along with an improved inflation outlook behind the 225bps of easing by SNB over 2months
- Even with a policy rate at 0.5%, SNB maintains a highly expansive stance, and is open to using unconventional measures to further loosen policy. Further, with SNB offering 1w, 3m and 12m repos at a mere 0.05%, rates are likely to remain low for a prolonged period of time
- The difference in the monetary policy of SNB and ECB together with a call for a weaker currency by Swiss policymakers is likely to keep CHF relatively weak vs. the Euro. Further, with the Dollar likely to come under pressure as Fed formally undertakes QE, CHF is likely to remain supported against the greenback

China

Global recession to accentuate cyclical forces on Chinese growth

Slowdown in China could have disruptive ramifications for the rest of the world

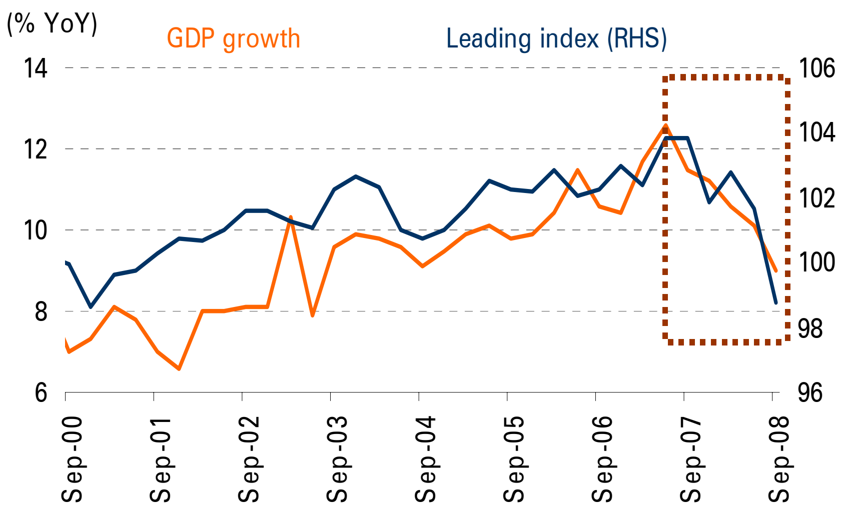
Massive policy stimulus to prop up the ailing economy

Further easing of monetary policy to complement the fiscal stimulus

Likelihood of a reversal in PBoC stance of gradual appreciation

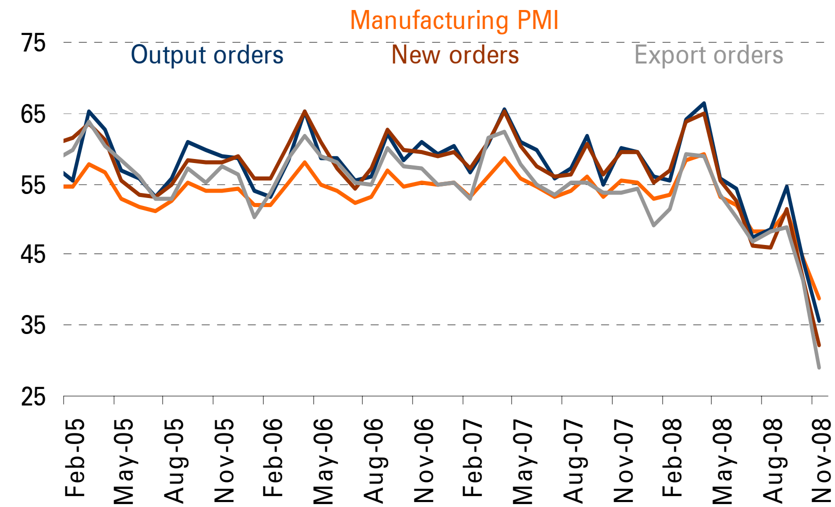
Alarm bells have started ringing in China

Leading indicator signaling single digit GDP growth in 2009



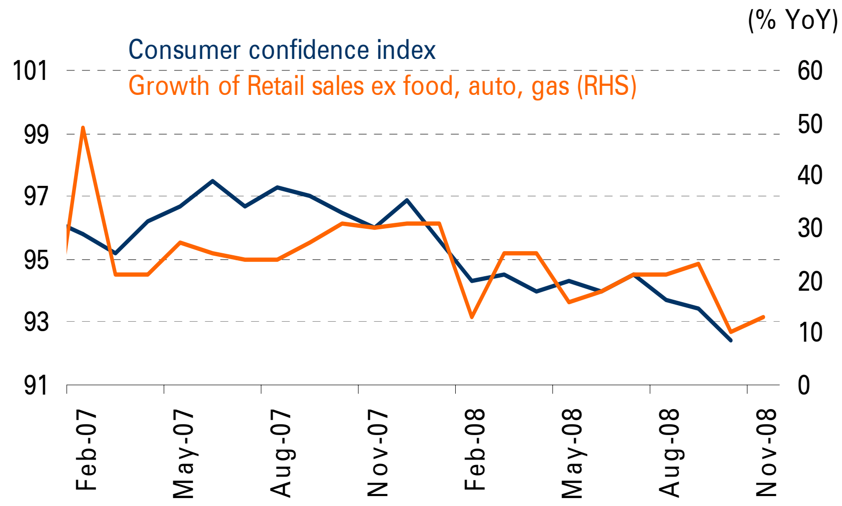
Source: Bloomberg, ICICI Bank Research

PMI at lowest levels ever, indicating bleak future for industrial output



Source: Bloomberg, ICICI Bank Research

Retail sales ex necessary goods has been drifting southward



Source: NBS, ICICI Bank Research

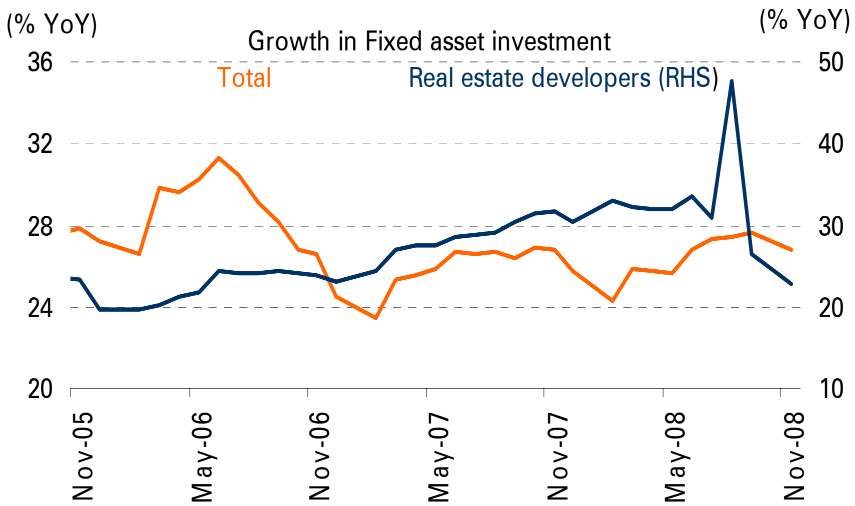
In short, serious growth concerns are rising

- The negative data prints since October, especially the surprise 9% growth in Q3, is indicative of the fact that the economy has been hit hard by the global economic crisis
- The cumulative impact of falling exports, past policy tightening cycles and the expected lull after Olympics has raised serious growth concerns. Consequently, social pressures are rising with companies laying off workers
- Consumption demand is unlikely to offset the adverse effects of falling industrial output and investment. Consequently, precautionary savings are set to rise further
- The outlook for the economy remains grim and given this bleak backdrop, the government will have to pull out all stops to attain the 8% growth target

ICICI Bank Corporate Solutions

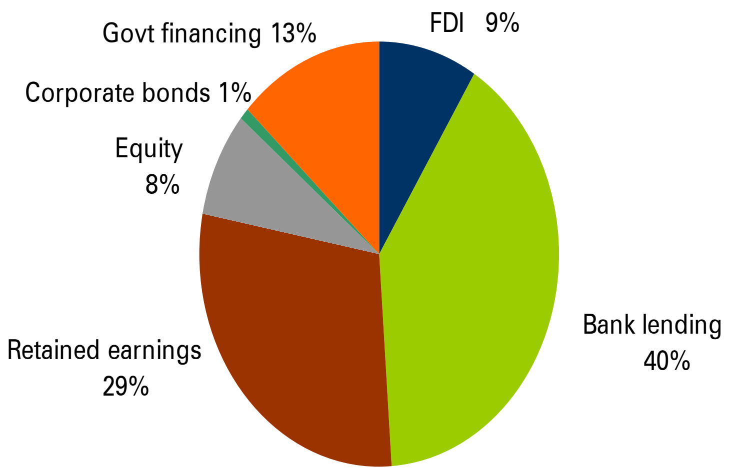
Investment growth still high but moderating

FAI levels have slowed down in 2008



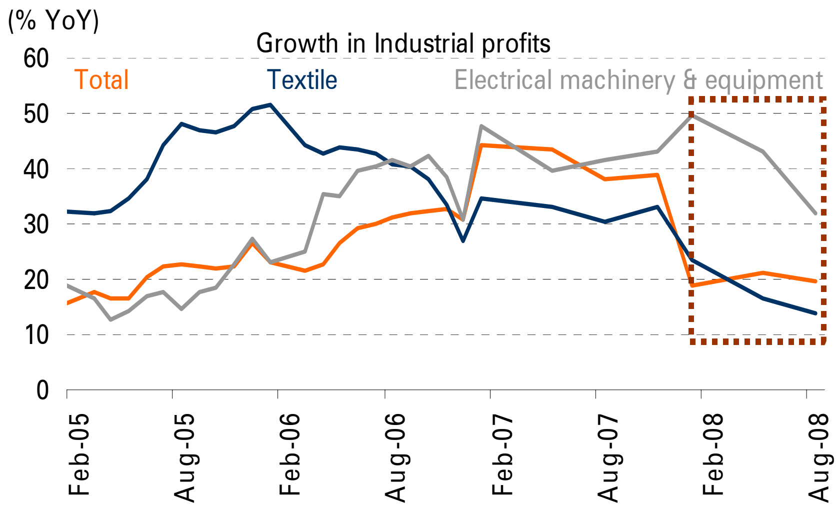
Source: Bloomberg, ICICI Bank Research

Investment financing dependent on bank lending & retained earnings



Source: CEIC, ICICI Bank Research

Declining industrial profits will shrink retained earnings…



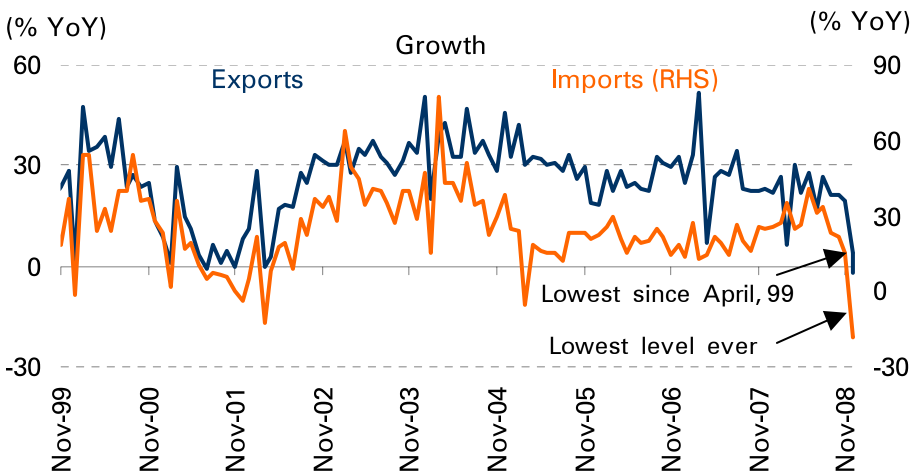
Source: CEIC, ICICI Bank Research

…and accentuate declining trend in FAI next year

- Due in part to past monetary and credit tightening cycles, investment has slowed in 2008, led by real estate sector and feeding into several other important industries
- Private investment might weaken in 2009, owing to paucity of funds. Retained earnings are suffering due to falling industrial profits. government policy support for rise in bank lending will be a positive, though the gradual drying up of capital flows and the overall growth scenario will be negative for investment
- government investment will rise further due to the heavy infrastructure investment intended as part of the fiscal package. We expect investment growth to continue declining in 2009, though government policy will be structured to provide the necessary support to the flailing investment situation

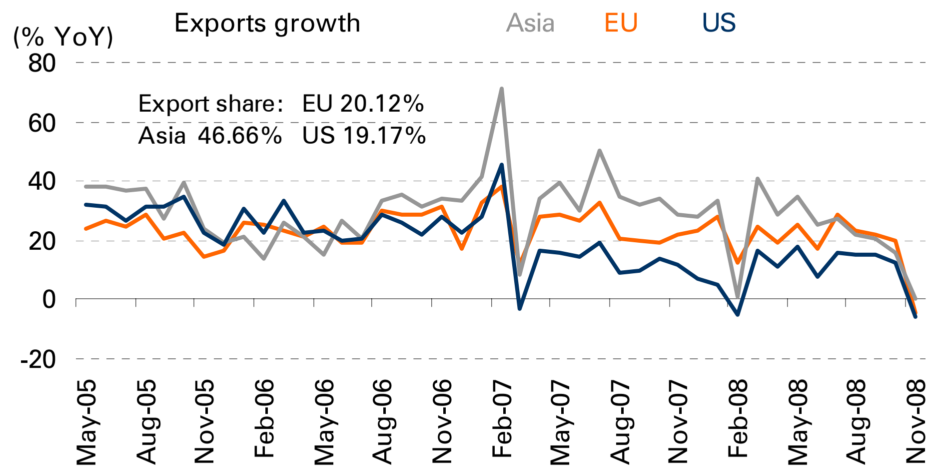
Export deceleration well under way

Exports & import growth have entered negative territory



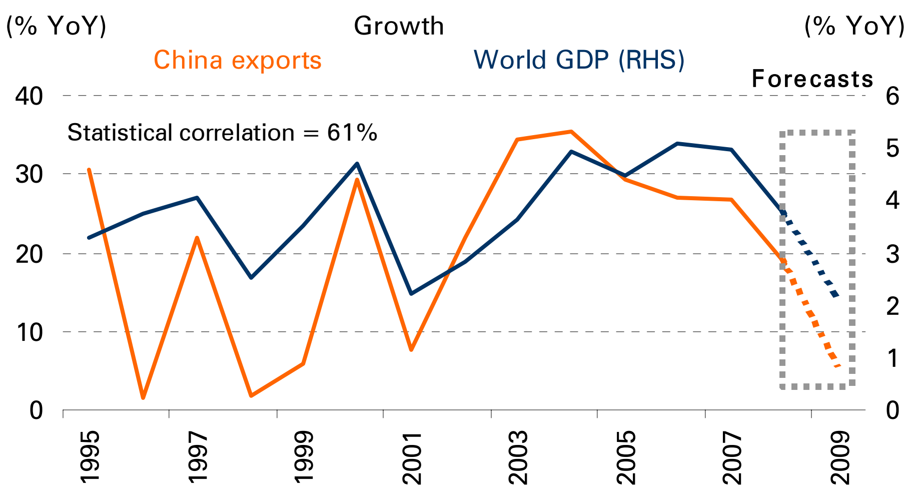
Source: Bloomberg, ICICI Bank Research

Owing to slowdown in large trading partners



Source: CEIC, ICICI Bank Research

Chinese exports to move down further following world GDP growth…



Source: Bloomberg, IMF, ICICI Bank Research

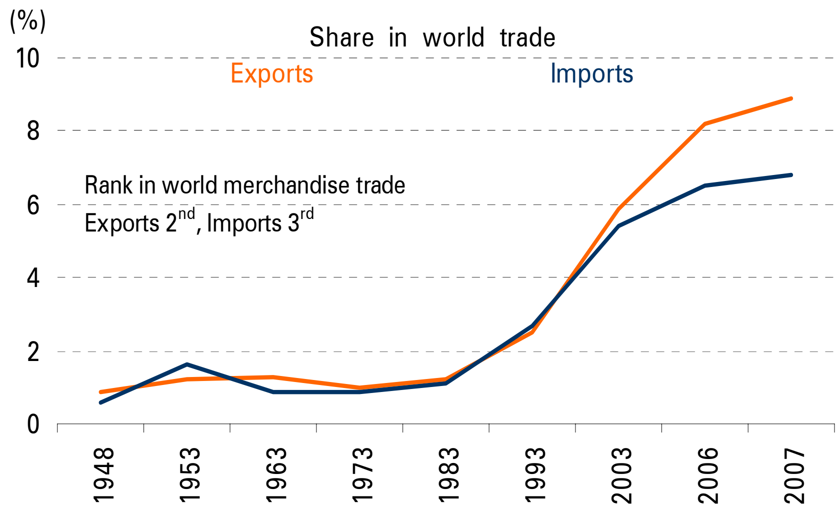
…and hence pose a huge risk to the Chinese growth

- Deepening recessions in advanced economies' have pummeled exports which is the main driver of the world's 4th largest economy.
- The worst hit is the light manufacturing sector, especially toy making factories, with more than 50% of them being forced to shut operations
- Falling export competitiveness has added to the sector's woes due to sustained currency appreciation
- Experience from past downturns shows that export growth fell from 22.6% to 7.1% in 1997 – 8, & from 30.6% to 9.6% in 2000 – 1.
- High correlation between China's export growth and World GDP growth substantially increases the risks of a sub 10% exports growth next year

ICICI Bank Corporate Solutions

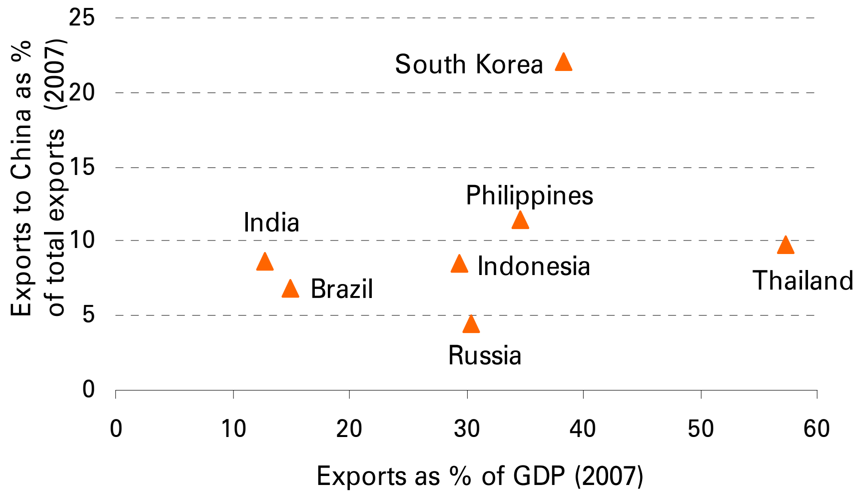
Reverberation of a Chinese trade slowdown to be felt globally

Leading position in world trade



Source: WTO World trade statistics,, ICICI Bank Research

High dependence of SE Asian economies on Chinese import demand



Source: Reuters Ecowin, ICICI Bank Research

China is a major determinant of global commodity prices

China and Commodities (2007)				
Commodity	Share of world (%)		Ranking in world	
	Consumption	Imports	Consumption	Imports
Energy				
Crude	9%	7%	2	3
Metals				
Aluminium	33%	-	1	-
Copper	27%	22%	1	1
Nickel	23%	20%	1	1
Tin	37%	-	1	-
Agriculture				
Cotton	41%	30%	1	1
Soybeans	21%	47%	2	1
Wheat	17%	-	2	-

Source: BP Statistical review, USDA, WBMS, ICICI Bank Research

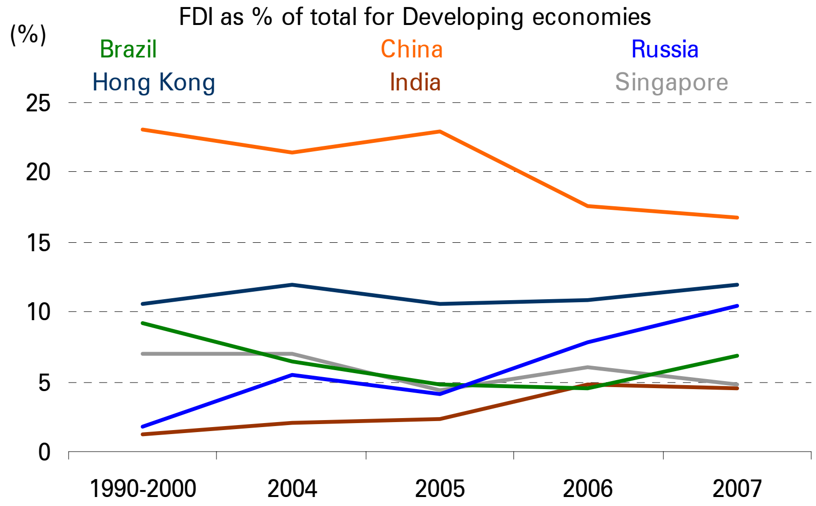
Chinese slowdown does not bode well for the EM bloc

- China holds prime position as a manufacturing hub and leading importer of intermediate goods & raw materials
- The dependence of other export driven EM economies on China is pretty high given the fact that they account for more than 50% of Chinese imports
- The Chinese growth slowdown will be detrimental for commodity exporters, especially Africa and Latin America
- The latest trade data is indicative of economic slowdown. The imports have exhibited the largest ever annual drop of 17.9%, with the imports from ASEAN falling by almost 26% (YoY). The world's No.2 oil consumer has exhibited the first ever drop in its crude imports since Jan 2006

ICICI Bank Corporate Solutions

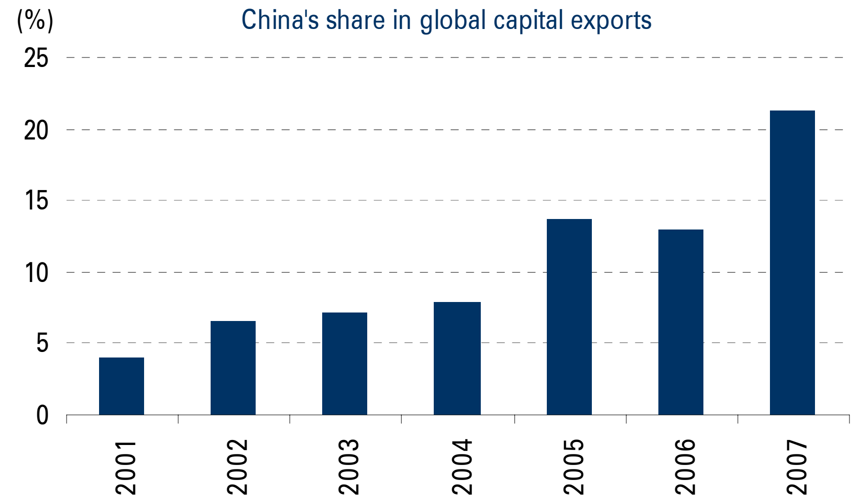
Freezing capital flows to contribute to Chinese slowdown story

China is not only the top FDI destination among developing economies



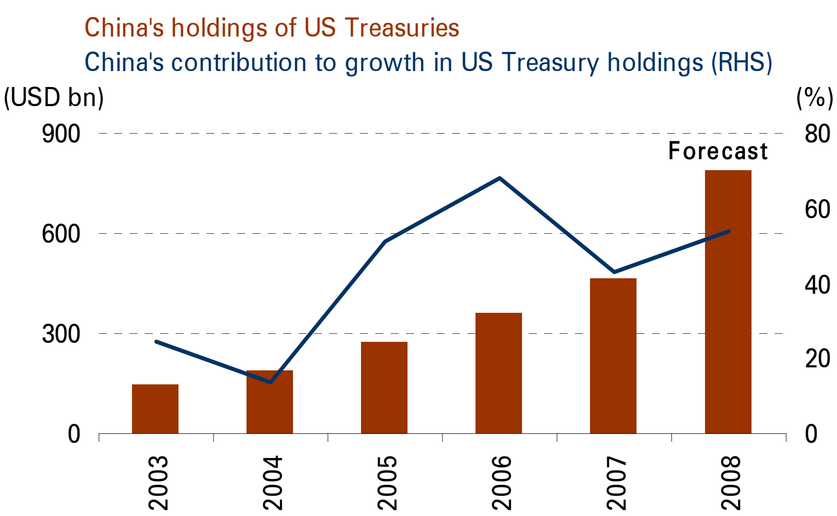
Source: UNCTAD, ICICI Bank Research

…but also the leading capital investor in the world



Source: IMF Global Financial Stability report , ICICI Bank Research

Even financing of the US fiscal deficit is critically dependent on China



Source: US Treasury, ICICI Bank Research

Global prospects will be intertwined with growth dynamics in China

- The rising Chinese growth trajectory had attracted a major chunk of global FDI flows, and also increased Chinese investment into natural resource industries in Latin America and Africa.
- The large capital flows, and substantial trade balance has contributed to burgeoning forex reserves and helped make China the world's largest holder of US Treasuries and an important financier of the US fiscal deficit. To maintain the current share in treasuries growth, China will have to invest almost USD 750 bn out of the USD 1.5 trillion fresh issuance expected next year. However, with falling forex reserves and huge stimulus package announced, the probability of this event is quite low, implying a substantial rise in Fed's burden

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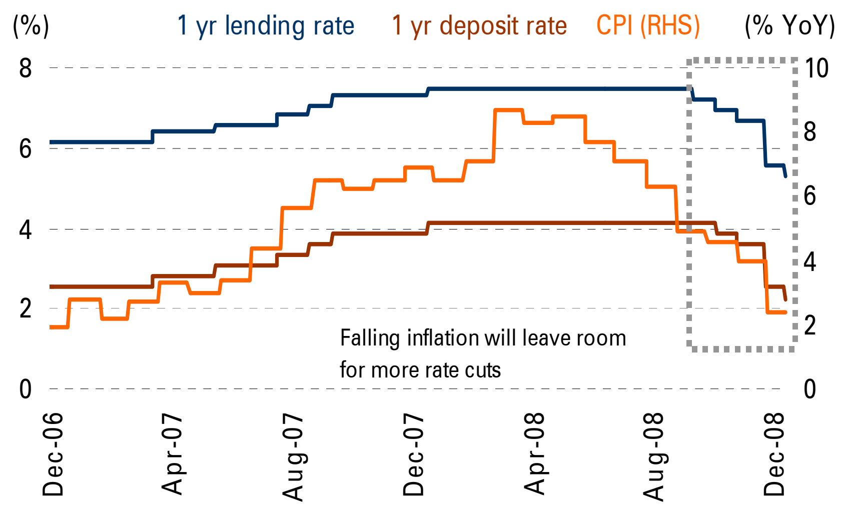
Authorities in overdrive mode to eliminate a tail risk event

Fiscal package of unprecedented magnitude

Component of policy package	Cost (RMB bn)
Construction of affordable housing	280
Rural infrastructure spending	370
Investment in transportation network	1800
Investment in medical services, culture & education	40
Spending on ecology protection	350
Expedite technical innovation & economic restructure	160
Sichuan earthquake reconstruction	1000

Source: NDRC, ICICI Bank Research

Monetary policy playing the second fiddle

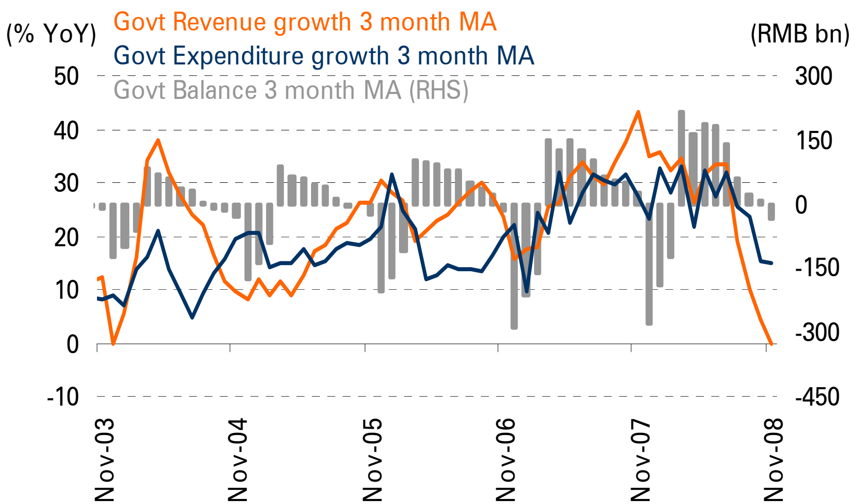


Source: Bloomberg, ICICI Bank Research

Government policy to remain pro active going ahead

- The fiscal package spread over next 2 years, is expected to boost GDP growth by 1 percentage point every year
- Almost 25% of spending is intended for earthquake reconstruction, while a meager 10% for medical, culture & education services. This might further boost the precautionary public behavior
- Further to this, the government has reduced taxes & boosted credit availability for the export and property sectors. Monetary policy response has been aggressive with five rate cuts already this year. We expect this trend to continue in 2009
- IMF has also expressed the need for stimuli to continue and we expect government policy to remain proactive going ahead. However, on the downside the risk remains that the fiscal deficit might shoot up substantially

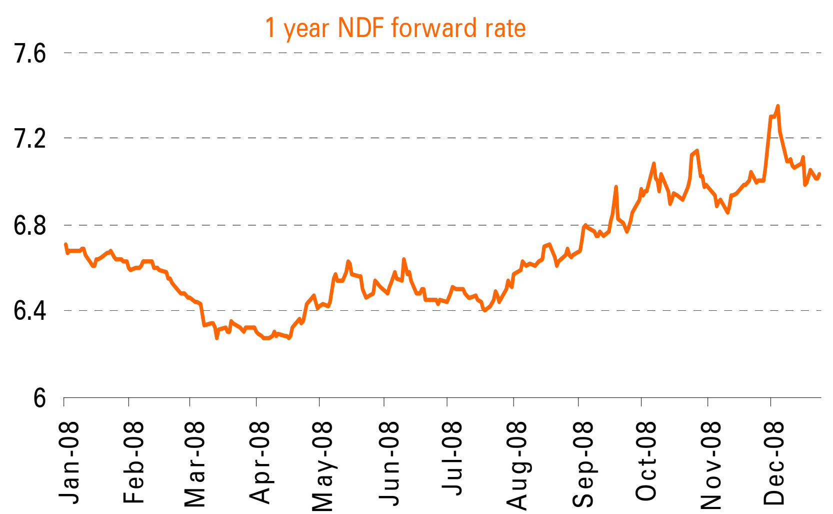
…But, risk of sharp rise in fiscal deficit



Source: CEIC, ICICI Bank Research

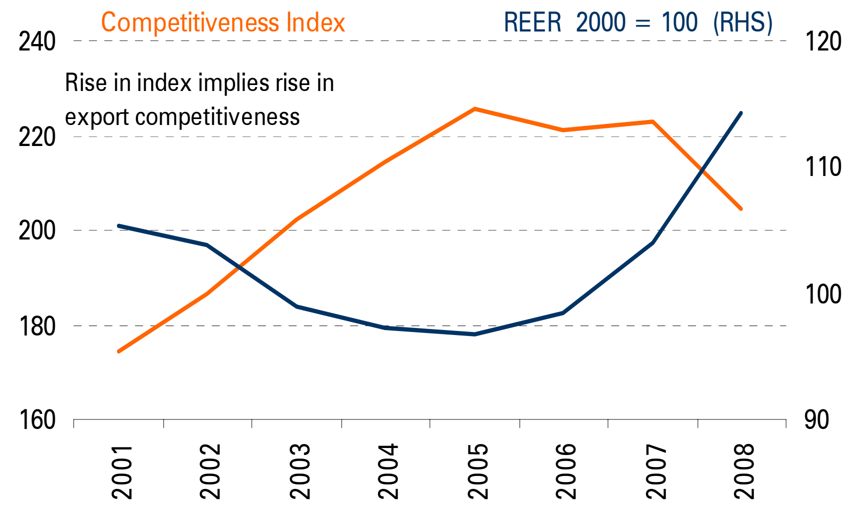
Likelihood of a reversal in PBoC stance of gradual appreciation

Markets pricing in devaluation pressures next year



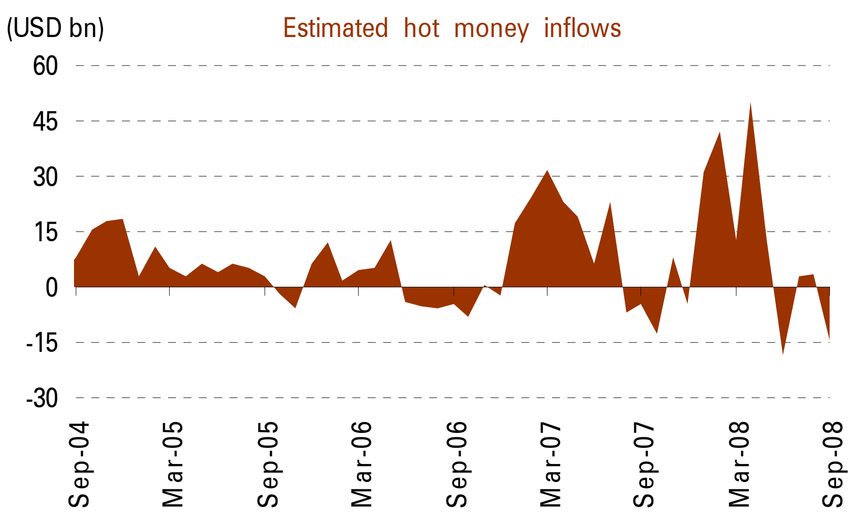
Source: Bloomberg, ICICI Bank Research

Fall in export competitiveness to weigh on PBoC policy



Source: Reuters Ecowin,IIF, ICICI Bank Research

Hot money flows likely to remain low next year…



Source: Bloomberg, ICICI Bank Research

…and mitigate the natural appreciation pressure on Yuan

- Yuan has appreciated consistently by almost 15.6% since July 2005 revaluation, leading to a fall in export competitiveness, vis-a-vis the advanced economies
- The global liquidity squeeze has started drying up capital flows, especially the hot money flows, thereby heightening expectations of Yuan depreciation. However, Dollar cues might pull the currency strongly on the opposite side
- Weak Yuan policy can trigger competitive devaluation and protectionist pressures from Western countries
- Overall, a reversal of appreciation stance is likely to be the theme playing out in 2009. However, the currency losses will remain capped owing to external pressures

India

Pervasive slowdown in growth, raising concerns over the health of the economy

Picture for FY10 clouded with uncertainty

Ebbing inflation and focus on growth to keep rates low

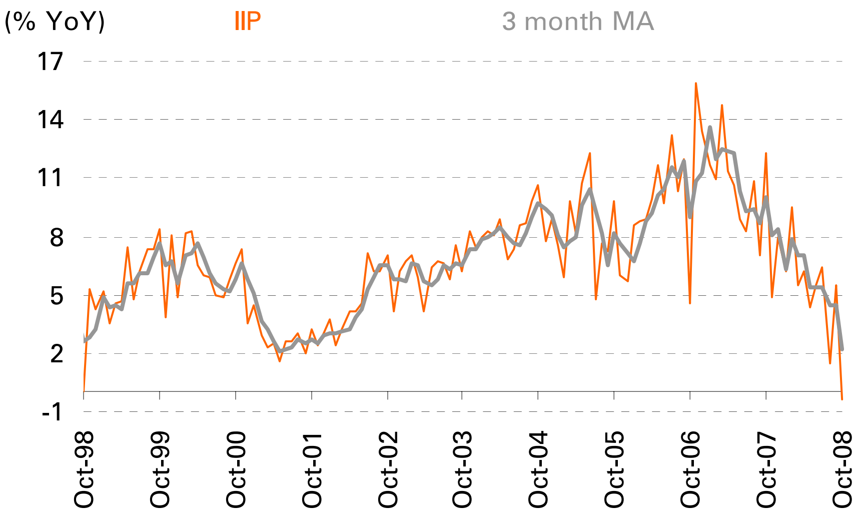
Expansionary fiscal policy to step up the strain on fiscal health

Little support from the BoP side this year as well

Dollar drift to support Rupee, but fundamentals remain weak

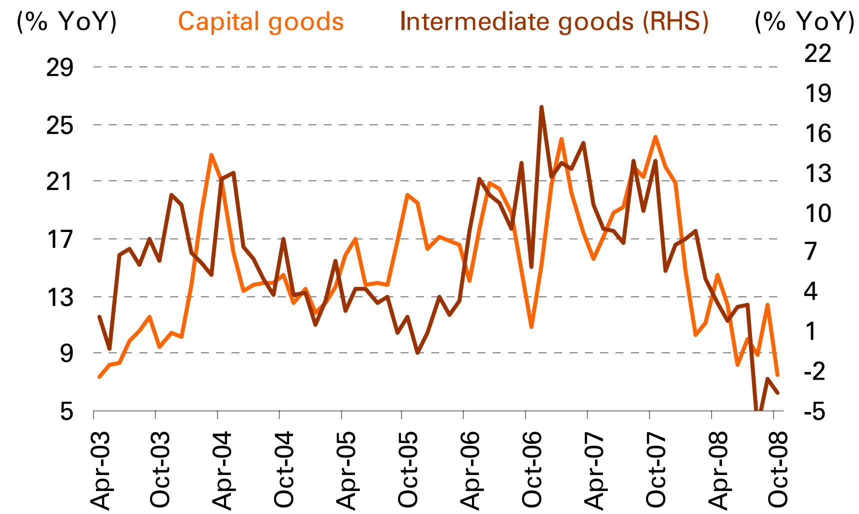
Across the board slowdown in growth indicators…

From double digit growth to negative growth in IIP…



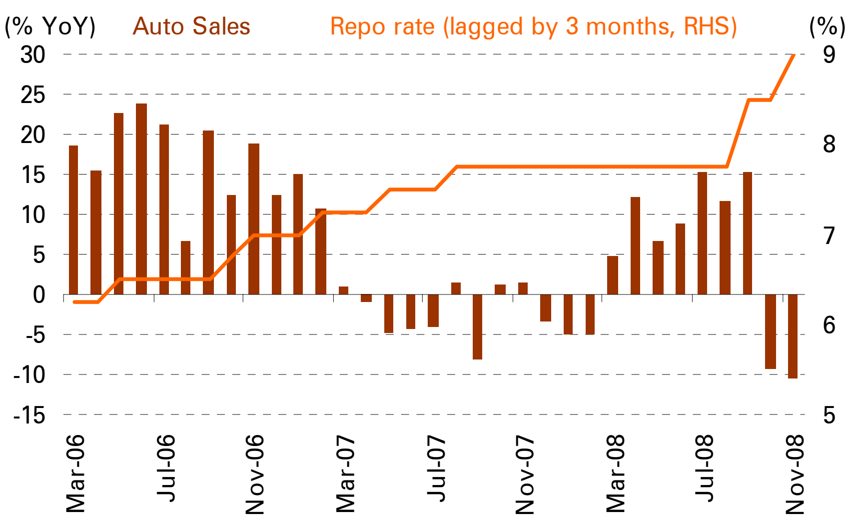
Source: CSO, ICICI Bank Research

…with core sectors taking a big hit



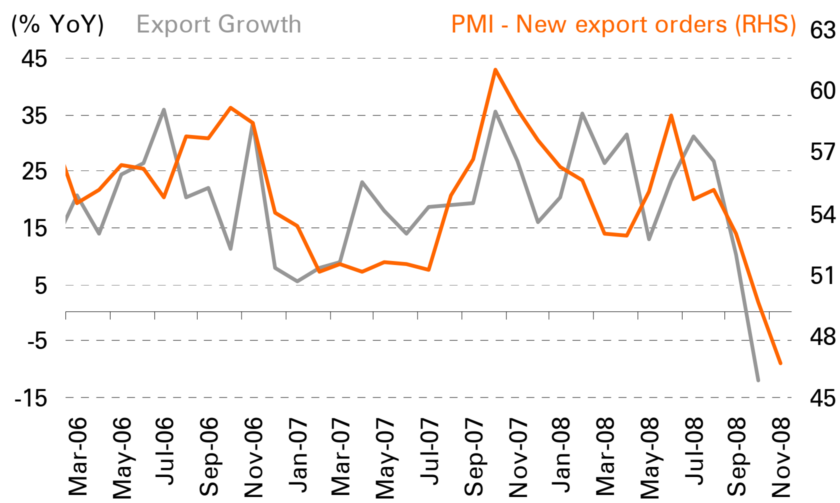
Source: CSO, ICICI Bank Research

Auto sales dipping on account of lagged effect of monetary tightening



Source: Bloomberg, ICICI Bank Research

Global recession to hit growth as exports fall



Source: Bloomberg, ICICI Bank Research

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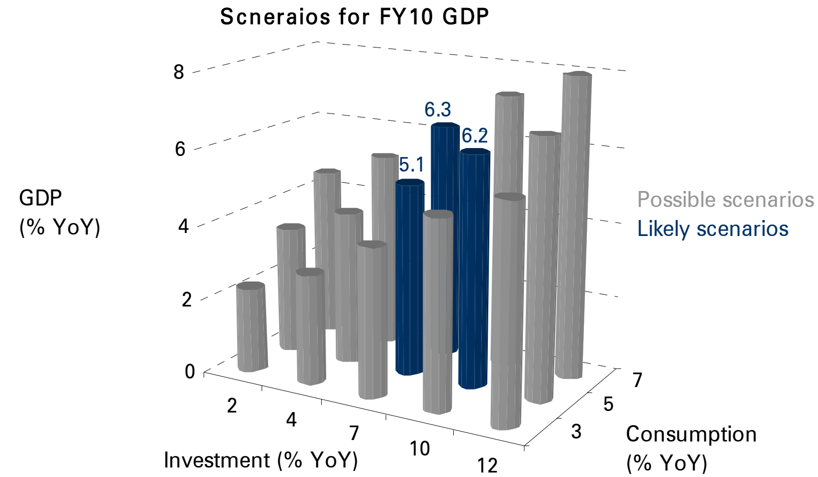
…a harbinger of tough times ahead

FY09 growth to be reasonable…

Growth rates (%)	GDP	Private consumption	Govt consumption	Investment	Exports	Imports
Average in last 13 years	6.93	5.81	5.51	10.21	14.37	15.51
Average in last 5 years	8.92	7.01	4.76	15.76	15.03	22.12
Average during slowdown	5.11	4.60	6.59	6.44	12.55	9.71
FY08	9.00	8.30	6.96	13.75	7.50	7.60
H1 FY09	7.74	6.50	8.10	11.40	16.00	23.00
FY09 (E)	7.00	6.8	7.3	10.3	15.0	18.6

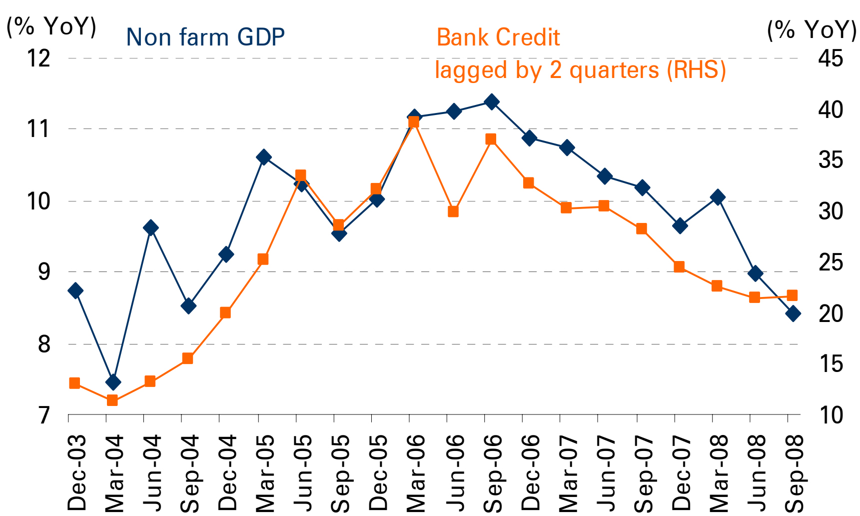
Source: CEIC, ICICI Bank Research

…however FY10 growth expected to edge lower



Source: ICICI Bank Research

Though credit growth seems to be healthy…



Source: CEIC, Bloomberg, ICICI Bank Research

…its sustainability remains uncertain

- Investment growth has been the bright spot over the last 5 years helping sustain growth at over 8%, however historically investment growth has been more volatile compared to consumption growth
- Growth for FY09 expected to remain near 7% levels. Forthcoming policy action would help to keep growth on track, however global headwinds and waning domestic demand keep the scenario for FY10 gloomy
- Pressure on bank credit to finance investment in FY10 would rise as non bank sources of funding are expected to dry
- Historically bank credit growth leads GDP growth by two quarters, and therefore in the current scenario sustaining a healthy credit growth is of paramount importance

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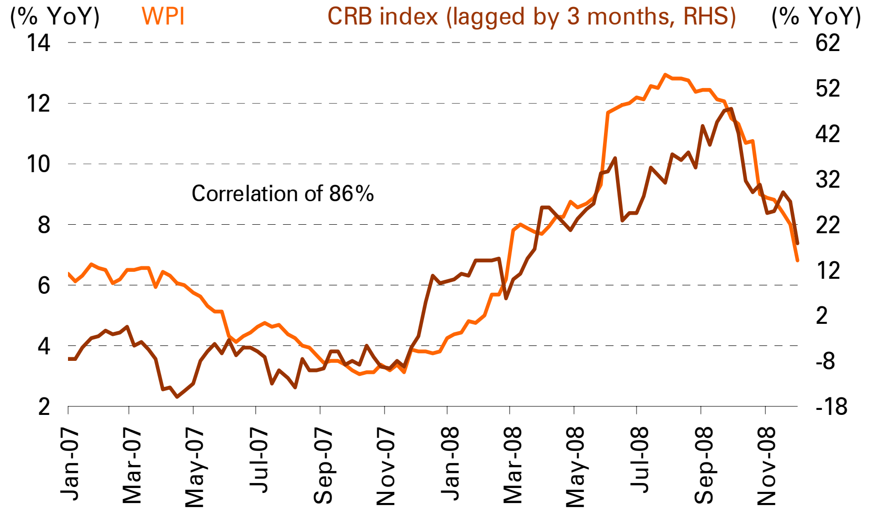
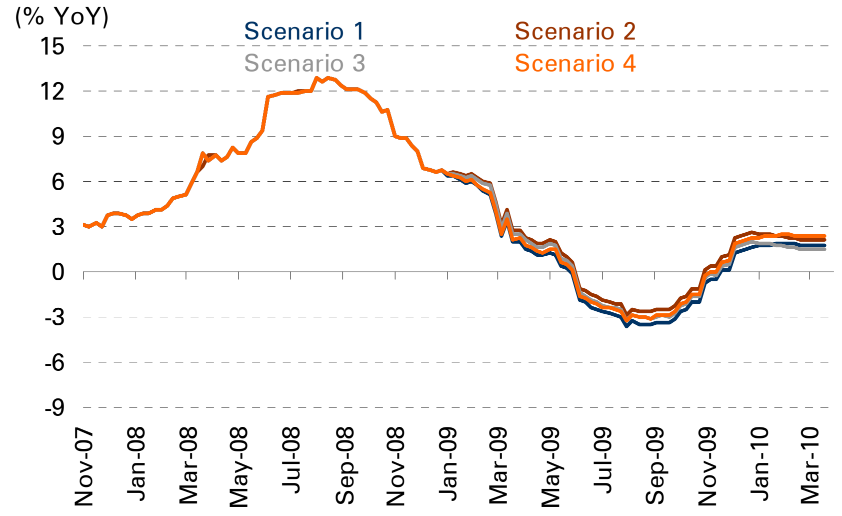
Ebbing inflation and growing growth concerns…

Global prices take a U-turn getting reflected in domestic prices



Source: Bloomberg, ICICI Bank Research

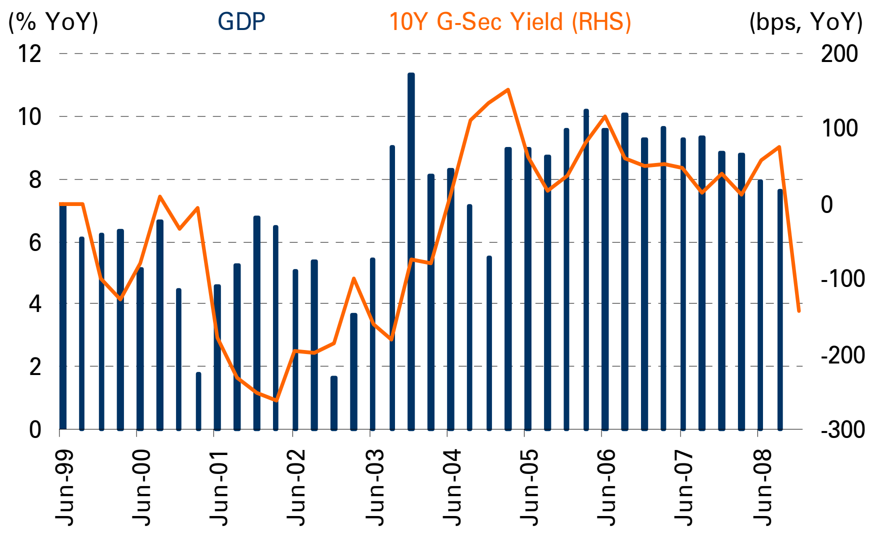
Inflation expected to remain benign in the coming year



Source: Bloomberg, ICICI Bank Research

Scenario 1	Primary below trend, mfg below trend, fuel below
Scenario 2	Primary above trend, mfg stable, fuel stable
Scenario 3	Primary below trend, mfg stable, fuel stable
Scenario 4	Primary stable, mfg stable, fuel below trend

Falling G-sec yields harbinger of slowing growth



Source:GOI, ICICI Bank Research

- With recessionary conditions expected to dominate next year commodity prices should remain muted
- Scenario analysis depicts inflation to remain within RBI's comfort zone of 5% next year
- Slowing domestic demand, ebbing inflation and dramatic shift in stance of monetary policy is pointing towards the fact that more rate cuts are in the offing

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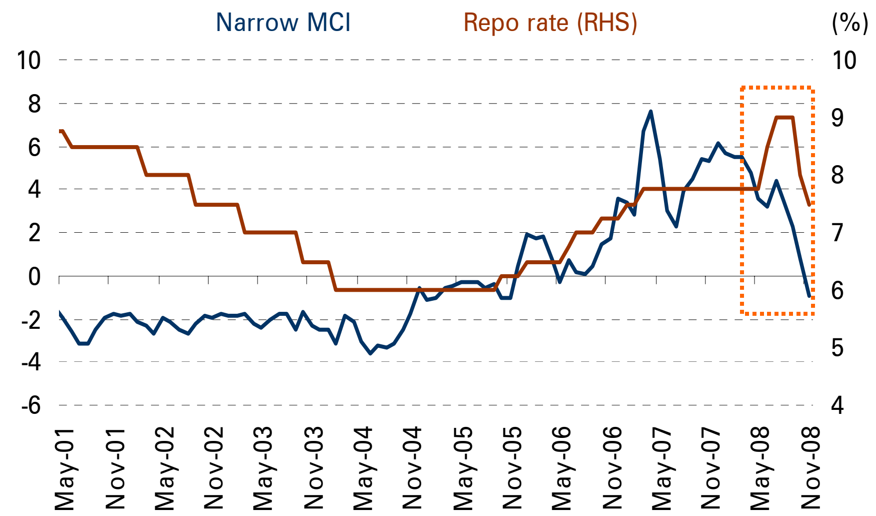
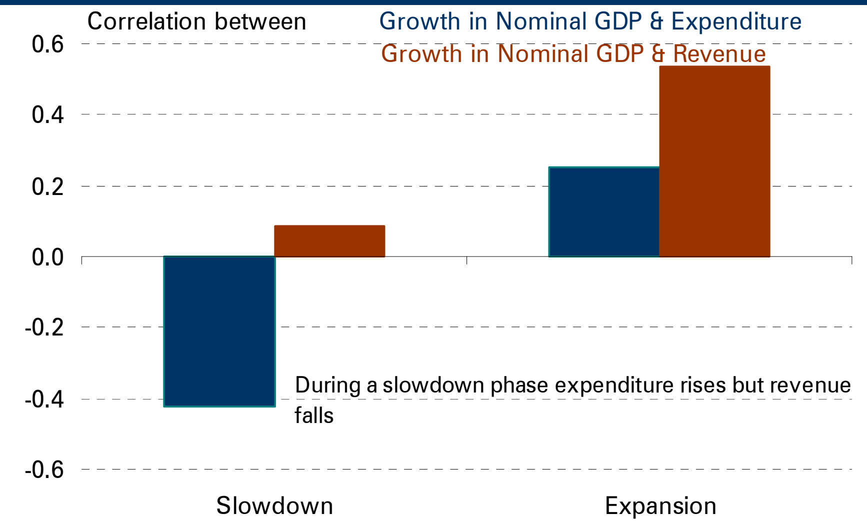
...leading to expansionary monetary and fiscal policy

Monetary easing soothes the elevated stress on monetary conditions



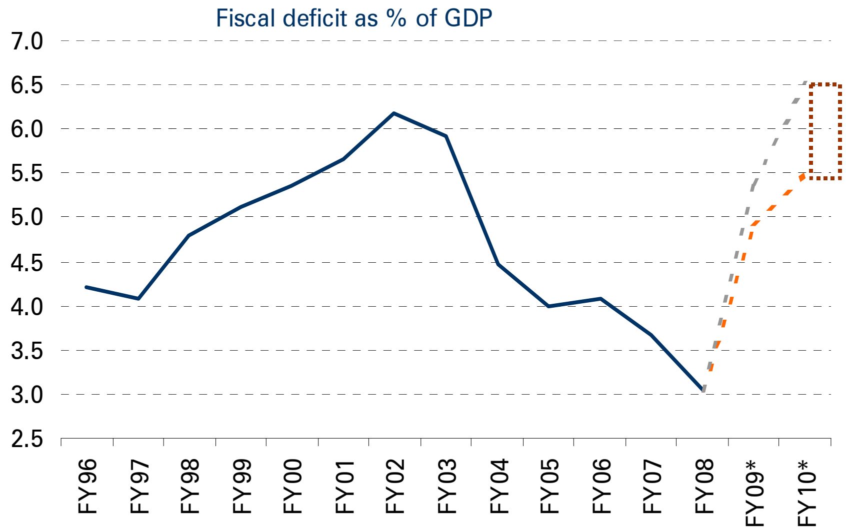
Source: Bloomberg, ICICI Bank Research

A slowing economy is likely to put pressure on government finances…



Source: GOI, ICICI Bank Research

…resulting in abandonment of FRBM targets



* Estimates

Source: Bloomberg, ICICI Bank Research

Lower rates and high fiscal deficit expected in the coming year

- Proactive actions by RBI have helped to ease strains in the monetary conditions, however there still remains room for easing further supporting our view that rates would soften in the near term
- Fiscal deficit is expected to rise sharply in FY09 mainly due to the populous measures taken by the government and the stimulus package of INR 315 bn
- With difficulty in mobilising private investments, fiscal policy is expected to remain expansionary and encourage government investment
- With a growing fiscal deficit, there is a risk that market borrowing may increase to finance the same which can be a potential risk to bond yields
- A combination of fiscal stimulus and monetary easing would be required to avert a prolonged downturn

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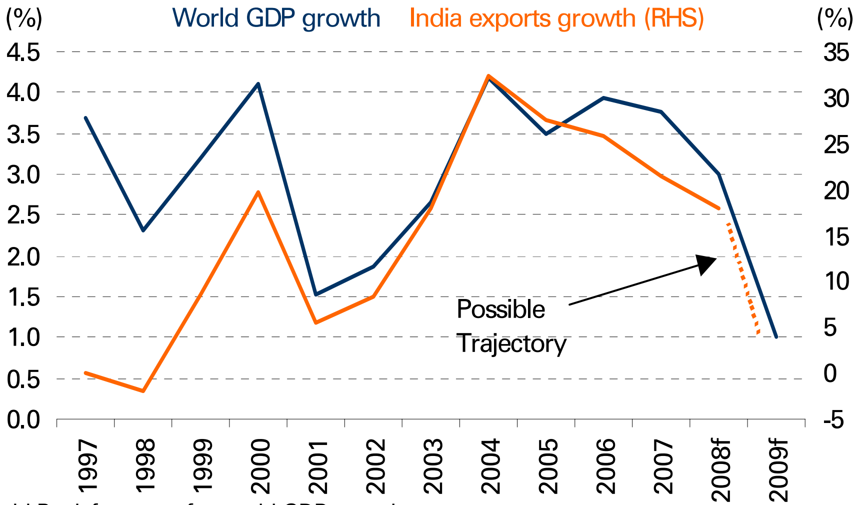
Things could remain as bumpy for Rupee in 2009

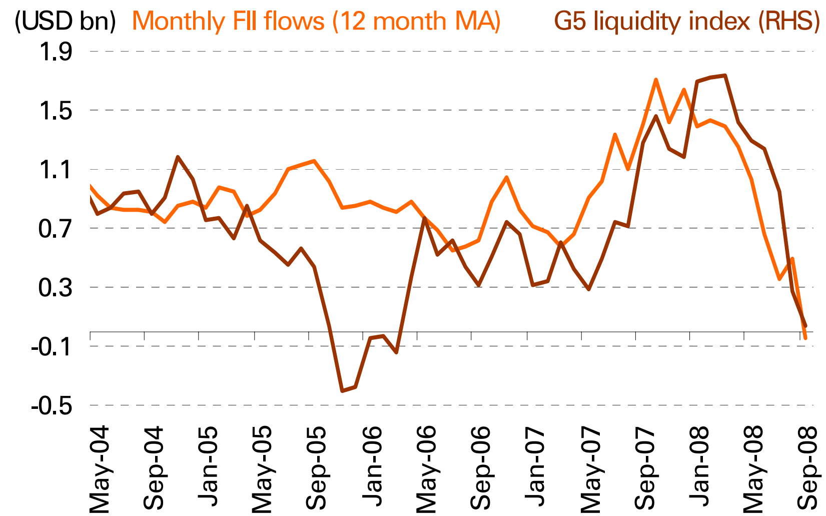
Exports growth can take a severe hit in coming quarters



*World Bank forecasts for world GDP growth

Source: World Bank, Bloomberg, ICICI Bank Research

Deleveraging would likely ensure very little support from the capital front



Source: Bloomberg, Reuters Ecowin, ICICI Bank Research

Reversal in global sentiment key to BoP outlook

	(USD bn)	FY07	FY08	FY09f	FY10f	
					Optimistic	Pessimistic
1	Merchandise	-63.2	-90.1	-127.0	-100.0	-135.0
	- Exports	128.1	158.5	168	185.0	175.0
	- Imports	191.3	248.5	295.0	285.0	310.0
2	Invisibles	53.4	72.7	86.0	94.0	88.0
	Total Current Account	-9.8	-17.4	-41.0	-6.0	-47.0
1	Foreign Investment	15.5	44.8	8.0	22.0	8.0
	- FDI	8.5	15.5	20.0	18.0	8.0
	- Portfolio Investment	7.1	29.3	-12.0	4.0	0.0
2	Loans	24.5	42.0	9.0	10.0	4.0
3	Banking Capital	1.9	11.8	0.0	4.0	0.0
4	Other capital	4.0	9.6	-4.0	0.0	-2.0
	Total Capital Account*	46.4	109.6	13.0	36.0	10.0
	Overall Balance of Payments	36.6	92.2	-28.0	30.0	-37.0

Source: RBI, ICICI Bank Research

Flow outlook remains grim, Dollar cues to help determine moves

- Current account deficit could likely remain at high levels despite the relief from oil prices. Exports growth could prove to be spoilsport this time around
- Much will depend upon the extent of further global deleveraging we are likely to witness in 2009
- In the most likely scenario, we are not likely to see much pressure on either side from the BoP front
- Therefore, Rupee movements are likely to be more a function of overall Dollar cues rather than its own fundamentals. With Dollar expected to weaken over the medium to long term, we can expect the Rupee to gain some lost ground in coming quarters
- However, we also note that Rupee would likely under-perform constrained by its weak overall fundamentals

Summary of Main Forecasts

Currencies

	Mar-09	Jun-09	Sep-09	Dec-09
USD/INR	49.25	47.00	45.00	43.50
EUR/USD	1.35	1.43	1.53	1.55
GBP/USD	1.39	1.44	1.52	1.56
USD/JPY	87	91	96	99
USD/CHF	1.14	1.10	1.07	1.05
AUD/USD	0.64	0.70	0.76	0.80
NZD/USD	0.57	0.60	0.64	0.66
USD/CAD	1.22	1.18	1.12	1.10

Policy Rates

	Mar-09	Jun-09	Sep-09	Dec-09
India	5.00/3.75	4.50/3.25	4.50/3.25	4.50/3.25
US	0.0% to 0.25%	0.0% to 0.25%	0.0% to 0.25%	0.0% to 0.25%
ECB	2.00	1.50	1.50	1.50
Japan	0.10	0.10	0.10	0.10
BoE	1.00	1.00	1.00	1.00
SNB	0 to 0.5%	0 to 0.5%	0 to 0.5%	0 to 0.5%
Australia	3.75	3.75	3.75	3.75
NewZealand	4.75	4.25	4.25	4.25
Canada	1.00	0.75	0.75	0.75

Yields

	Mar-09	Jun-09	Sep-09	Dec-09
India 10yr	4.50	4.00	4.50	5.00
US 10yr	2.00	1.80	1.60	1.80
Japan 10yr	1.20	1.15	1.15	1.30

LIBORs

	Mar-09	Jun-09	Sep-09	Dec-09
USD 6M	1.40	1.20	1.00	0.80
JPY 6M	0.95	0.85	0.85	0.85
CHF 6M	0.75	0.65	0.60	0.50

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