MACRO METER

Strong growth; inflation falls to comfort levels

June 14, 2007

Manika Premsingh
+91-22-4019 4847
manika.premsingh@edelcap.com

Policy

- The Finance Ministry tightened ECB norms in order to curb the excessive capital inflows coming into the country.

Real activity

- GDP growth numbers for FY-07 came in stronger than expected at 9.4% Y-o-Y. Growth for the previous three quarters was revised upwards. Industry and services continued to support.
- IIP in April came in at a stronger than expected 13.6% Y-o-Y. Manufacturing continued to contribute most significantly to IIP

Inflation

- Inflation fell below the 5% RBI target level, to end at 4.85% Y-o-Y by the end of May. The softening in inflation is on account of primary articles inflation. Manufactured products and fuel group inflation also supported.

Government finances

- The fiscal deficit-GDP ratio for FY07 came in at 3.5%, lower than government estimates of 3.7% and 4.1% in FY06.

Monetary developments

- Growth in M3 has started decelerating, in line with a come off in credit.
- Deposit growth too slowed down.

External sector

- Trade deficit for April FY-08 rose to the highest ever of USD 7 bn, possibly reflecting the impact of a sharp rise in the exchange rate.
- The rupee appreciated against the USD, resulting in a stronger forex kitty.

Economy snapshot

Indicator	FY-05	FY-06	FY-07
Real GDP (% Y-oY)	7.5	8.4	9.4
Agriculture	0.7	3.9	2.7
Industry	8.6	8.8	10.9
Services	9.9	10.1	11.0
Credit (% Y-o-Y)	32.6	32.3	29.2
M3 (% Y-o-Y)	14.4	17.0	19.5
WPI inflation	5.7	3.5	5.3
Imports (USD bn)	107	134	176
Exports (USD bn)	79	94	120
Current account balance (USD bn)	(5.4)	(10.6)	(13.8)
Capital account balance (USD bn)	31.0	25.6	29.7
Fiscal deficit/GDP (%)	4.0	4.1	3.5

Source: CMIE, RBI, Ministry of Commerce, Office of Economic Advisor

Policy: ECB norms tightened

- The Finance Ministry tightened External commercial borrowing norms, in a bid to curb excessive capital flows into the country. It has made two changes to the current ECB norms:

  1) The ceiling on interest rates payable for ECBs has been revised downwards. For loans with maturity ranging between 3-5 years, the ceiling has been lowered from 200bps above 6 month LIBOR rate to 150bps above 6 months LIBOR rate. The ceiling has been lowered from 350bps above 6 months LIBOR rate to 250bps above 6 months LIBOR rate for loans with over 5 years maturity.

  2) Exemption accorded to the 'development of integrated township' as a permissible end-use of ECBs has been withdrawn.

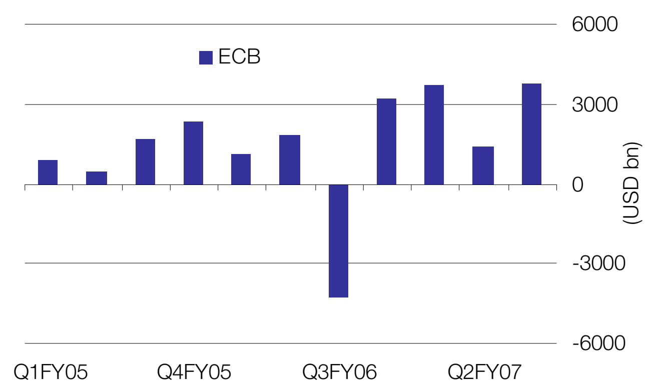
- The latest move came in the wake of (i) still lingering concerns over credit growth in excess of 25%, and specifically credit quality and (ii) sharp rupee appreciation since the beginning of FY08.

- We believe that more such moves could be due. Since the Finance Ministry has expressed its concern on rupee appreciation. And real estate has in particular been a source of concern, given the still existing risk of an asset price bubble in the sector.

- We had pointed to the possibility of tightening norms on ECBs in the April policy meeting of the central bank, given the strong flows from borrowings. While the RBI refrained from any such move then, the FM has changed the norms now.

- It needs to be noted that this move came the very day that the People's Bank of China tightened in a bid to control the liquidity situation. Both India and China face similar concerns – high growth and the threat of potential overheating. Give the coherence in the global interest rate cycle, timing of more such moves could be determined by global policy actions.

ECB on the rise



Source: CSO, Bloomberg

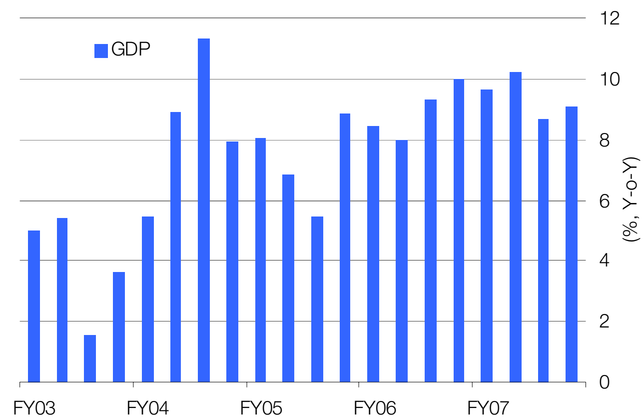
Strong GDP numbers in FY-07

- India continued to show strong growth for the fourth consecutive year; with FY07 ending at a high of 9.4% Y-o-Y. Our estimates as well as street expectations had indicated a growth of 9.0% Y-o-Y. The upside on growth is on account of upward revision to growth in the previous three quarters, with the number being close to our forecasts for Q4 FY07. Q4 growth came in at 9.1% Y-o-Y, up from 9.2% as per estimates.

- The break up of FY07 growth across components reveals continued strong industry and services performance. Within industry, manufacturing showed a strong 12.3% growth. 'Electricity, gas and water supply' and construction sectors provided support as well. Services' components showed strong growth across the board. 'Trade, hotels, transport and communications' showed acceleration in growth from FY06. In Q4 FY07, however showed some deceleration in services growth over the previous quarter, on a softening across all three segments. Industry growth however remained strong in Q4 as well. Agriculture, in particular, provided an upside to Q4 growth – increasing by 3.8% Y-o-Y, up from 1.6% Y-o-Y during the previous quarter.

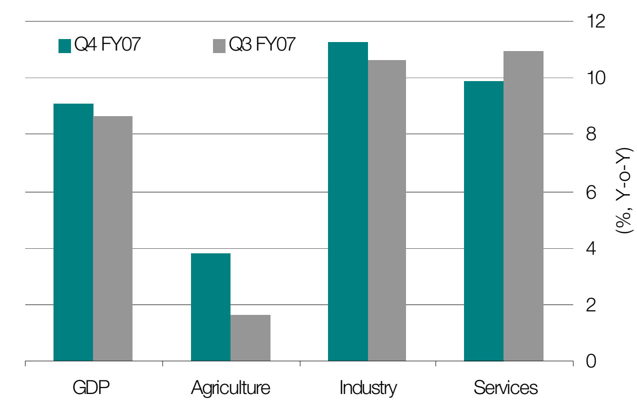
- For the first time, the CSO reported quarterly GDP estimates by expenditure components. In terms of proportions, the capital formation remains on a strong footing, contributing now to a little over 30% of the GDP. This is primarily at the cost of a loss in consumption's share to about 54% for Q4 from over 57% in Q1.

Above trend growth continues



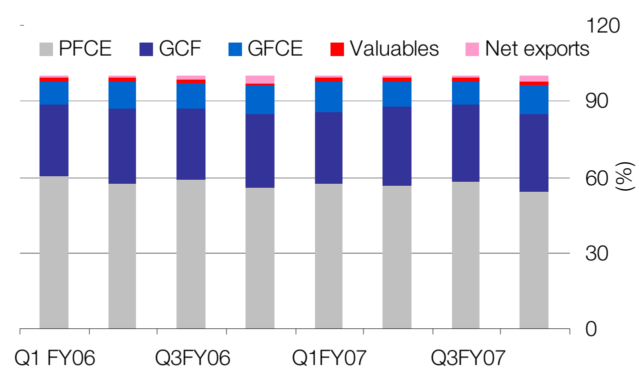
Source: CSO, Bloomberg

Industry and services lead



Source: CSO, Bloomberg

Rising share of GCF

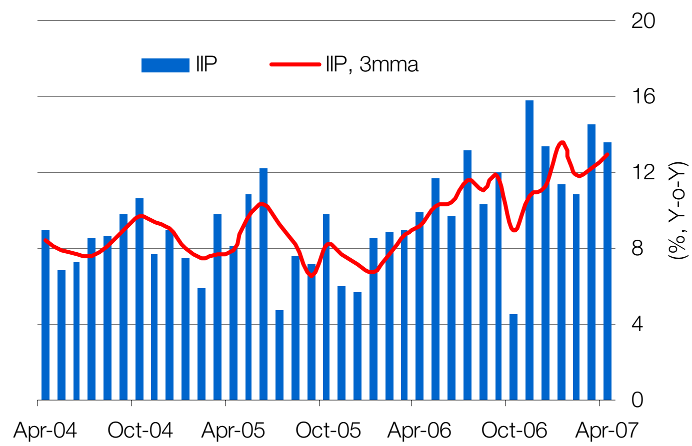


Source: CSO, Bloomberg

Industrial production sharply up

- Industrial production for April came in at a stronger than expected 13.6% Y-o-Y, above expectations. March growth was also revised upwards to 14.5% Y-o-Y, up from an already strong12.9% Y-o-Y.
- Manufacturing continued to contribute most significantly to IIP (15.1% Y-o-Y). Electricity also showed strong growth of 8.7% Y-o-Y, up from 7.9% during March. Mining however lagged behind, growing only by 3.4%.
- As per the use-based classification, the consumer goods and capital goods supported – growth both grew by 17.7% Y-o-Y. Basic and intermediate goods growth remained sustained as well, though somewhat below the March numbers.
- There is a split in trend across the two components of consumer goods – consumer non-durables and consumer durables. Consumer non-durables demand continues to remain very strong (21.9% Y-o-Y, in comparison with 20.7% Y-o-Y in March). With a strong rabi season and expectation of normal south west monsoon, we should expect this sector to perform well. Consumer durables demand, however, has been hit by rising interest rates. Durables grew by a small 5.3% in April.

Stronger than expected IIP



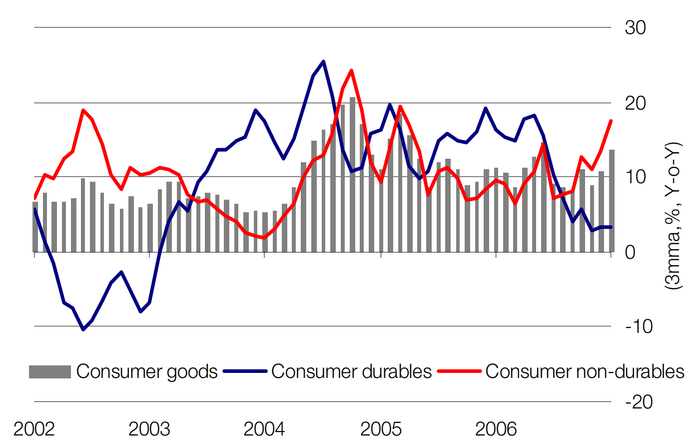
Source: CSO, Bloomberg

Industrial production (% Y-o-Y)

	Apr-07	Mar-07	Apr-06
Industrial production	13.6	14.5	9.9
Manufacturing	15.1	15.9	11.0
Mining	3.4	7.3	3.4
Electricity	8.7	7.9	5.9
Use-based categories			
Capital goods	17.7	18.2	19.6
Consumer goods	17.7	16.0	8.9
Consumer durables	5.3	3.3	7.4
Consumer non-durables	21.9	20.7	9.4
Basic goods	8.9	11.7	9.3
Intermediate goods	12.6	14.3	8.5

Source: Bloomberg, CSO

Consumer goods components deviate



Source: CSO, Bloomberg

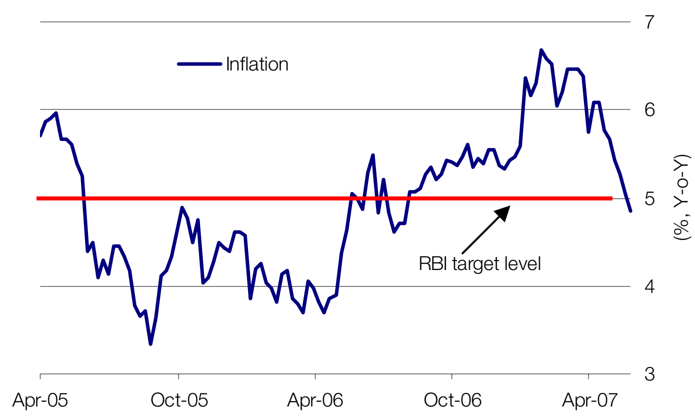
Inflation falls below RBI target level

- At the end of May inflation fell below the 5% RBI target level, to end at 4.85% Y-o-Y. While a decline in inflation to sub-5% levels had been expected, it came in sooner than expected. Going forward, we expect inflation to soften even further.

- The softening in inflation is on account of primary articles inflation, whose average monthly figures fell to 9.9 % Y-o-Y from 11.71 % during the previous month. Manufactured products and fuel group inflation also fell. While manufactured products inflation fell to 5.13% Y-o-Y from 5.59% Y-o-Y during the previous month. Fuel group numbers fell to 0.57% from 1.08%.

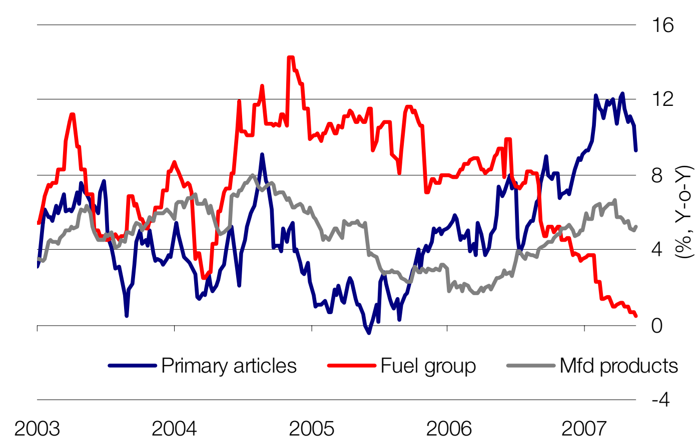
- Core inflation, our measure of demand side pressure on price levels in the economy also on the decline. It rose to levels higher than over all inflation starting January on account of a stronger low base effect. However, it is now falling in line with the decline in overall WPI inflation. The monthly average was at 6.66%, down from 7.05%.

Inflation - below RBI target level



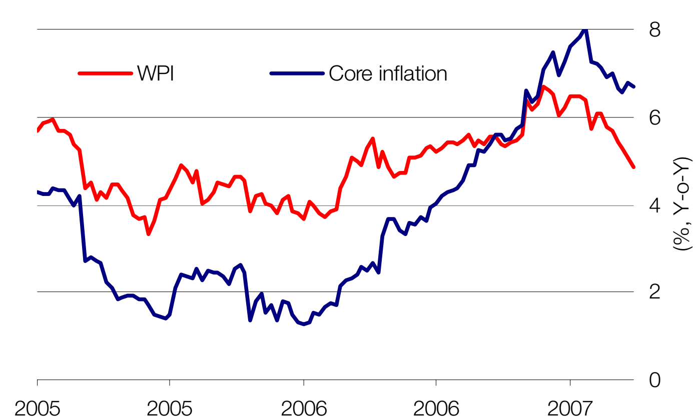
Source: Bloomberg

All components soften



Source: Bloomberg, Office of economic advisor

Core inflation on the decline

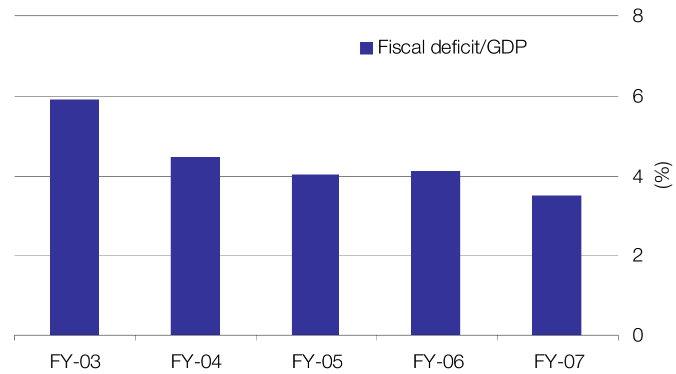


Source: Bloomberg, Office of economic advisor

Central government finances – Fiscal deficit contained

- The fiscal deficit-GDP ratio for FY07 came in at 3.5%, lower than government estimates of 3.7% and 4.1% in FY06. The lower than anticipated ratio was on account of (a) strong revenue growth (b) curtailment in expenditure and (c) higher than expected GDP base.
- Tax revenue remained particularly strong throughout FY07. FY07 gross tax revenue grew by a strong 30.1% Y-o-Y, up from 19.3% Y-o-Y growth in FY06. The share of direct and indirect taxes in total tax revenue remains largely unchanged (43% direct taxes and 57% indirect taxes). Under direct tax heads, both corporate and income tax have grown at a robust 15.8% Y-o-Y and 27.3% Y-o-Y respectively. For indirect taxes, the growth is not across the board – customs collections and other taxes (which include service tax) grew at a good 32.7% and 63.8% respectively, while excise collections lagged behind at 5.8% Y-o-Y.
- Total receipts for April stood at INR 84.2 bn against total expenditure of INR 362.3 bn. The gross fiscal deficit was at INR 278.1bn. So far, total receipts constitute 2.4% of the budgeted estimate while expenditure constitutes 7.4%. Expenditure is typically higher than collections in Q1, a trend that corrects itself over the remaining quarters of the financial year.

Fiscal situation improves



Source: CGA, CMIE

Annual central government accounts (INR bn)

	FY-08 (BE)	FY-07	FY-06
Total receipts	5,296	4,293	3,625
Revenue receipts	4,864	4,233	3,475
Net tax revenue	4,039	3,460	2,703
Non-tax revenue	826	774	772
Capital receipts (net)	432	60	141
Total expenditure	6,805	5,816	5,087
Non-plan expenditure	4,754	4,089	3,655
Non-plan revenue expenditure	3,835	3,622	3,279
Non-plan capital expenditure	919	467	376
Plan expenditure	2,051	1,727	1,406
Plan revenue expenditure	1,744	1,446	1,119
Plan capital expenditure	307	281	288
Gross fiscal deficit	1,509	1,523	1,461

Source: CGA, CMIE

FY08 central government accounts

	Actuals for April INR bn	% of Budget estimates Current	Prior
Total receipts	99	2.4	(0.5)
Revenue receipts	94	2.3	(0.5)
Net tax revenue	68	2.1	(0.1)
Non-tax revenue	26	3.4	(2.7)
Capital receipts (net)	4	3.6	(1.1)
Total expenditure	418	7.4	(5.9)
Non-plan expenditure	357	9.1	(6.5)
Non-plan revenue	356	10.3	(7.0)
Non-plan capital expenditure	1	0.3	(2.1)
Plan expenditure	61	3.5	(4.4)
Plan revenue expenditure	47	3.3	(4.9)
Plan capital expenditure	14	4.8	(2.4)
Gross fiscal deficit	320	21.5	(18.8)

Source: CGA, CMIE

Trade data gets worrisome

- Trade deficit for April FY-08 rose to the highest ever of USD 7 bn, possibly reflecting the impact of a sharp rise in the exchange rate. The rupee appreciated by 4.3% over March, in comparison to the FY07 average monthly appreciation of 0.08%. The trade deficit number is likely to acquire significance over FY08 due to recent trends seen in the rupee.

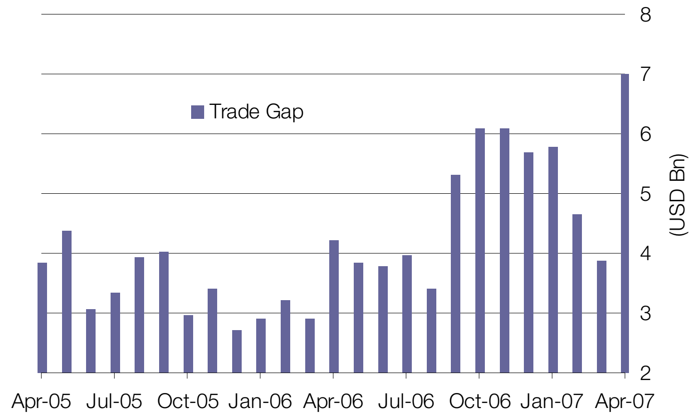
- The absolute figure for imports stands at USD 17.6 bn, up from USD 16.4 bn from the previous month. Exports have fallen since March; the figure is at USD 10.6 bn, down from USD 12.5 bn. It needs to be noted however, that exports were above average in March, and the April figures are still above the previous 12-month average of USD 10 bn. Imports, however, are stronger than the 12-month average of USD 14.7 bn.

- Growth over the previous year remains strong for both imports and exports. Imports grew by a strong 40% Y-o-Y, much above the 12-month average of 32%, while exports grew by 27% Y-o-Y, a tad below the 12-month average of 29.5%.

.

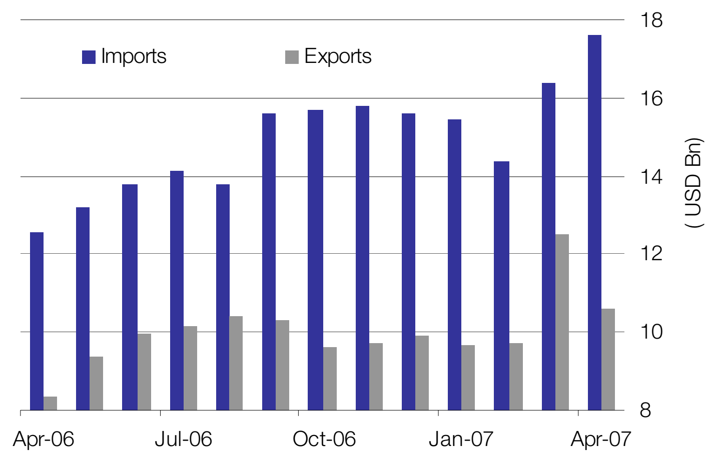
- The breakup of imports in oil and non-oil shows continued strength in non-oil imports, while oil imports have fallen marginally. Non-oil imports rose to USD 13.2 bn in April, from USD 11.8 bn in March, while oil imports fell to USD 4.2 bn from USD 4.5 bn in March. The strength in non-oil imports is a positive, since it reflects sustained domestic consumption demand.

Trade deficit zooms



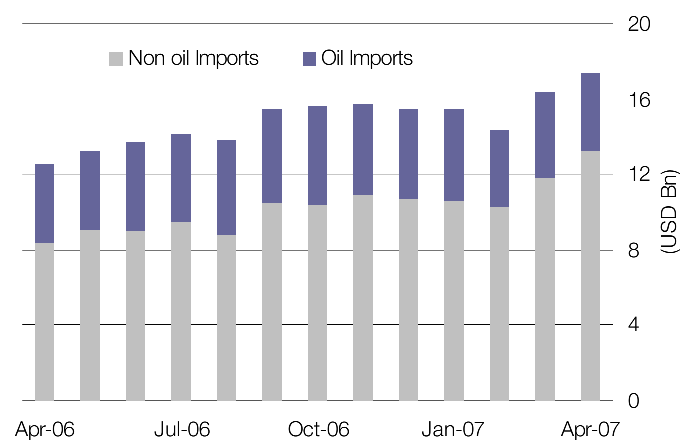
Source: Ministry of Commerce

Imports rise, exports remain steady



Source: Ministry of Commerce

Oil imports come off

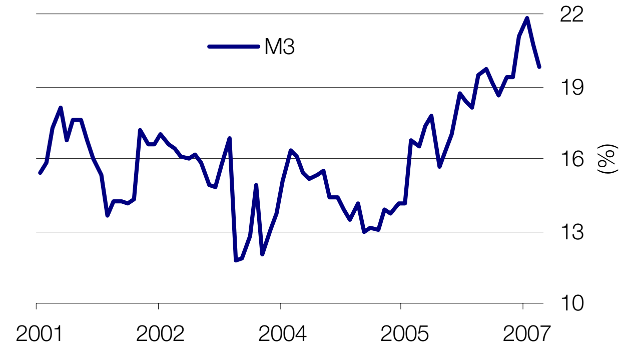


Source: Ministry of Commerce

✻ Liquidity situation in check

- Money supply growth has steadily declined since the start of FY-08, in line with a come off in credit growth. It declined from 20.7% Y-o-Y at the end of FY-07 to 19.8% Y-o-Y at the end of April, and is further down to 19.6% Y-o-Y for the last fortnight of May.

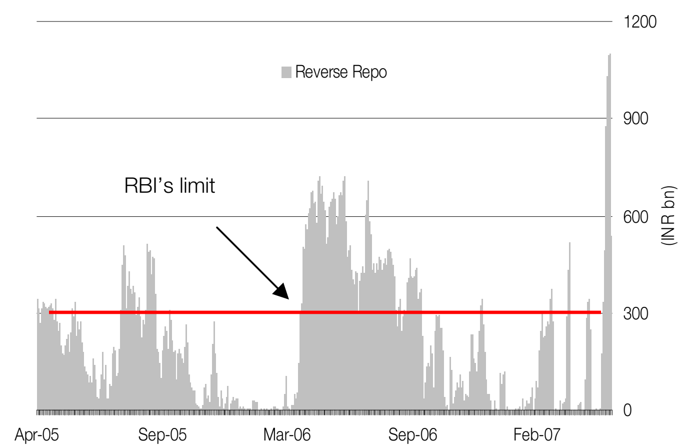
Money supply growth comes off



Source: Bloomberg

- Liquidity continues to be ample in the system – as reflected in the daily reverse-repo auctions. We look at amount received as bids under these operations as indicative of liquidity (since the amount accepted has been capped at INR 300 bn per day).The amount received stood at INR 93.35bn at the end of April and at INR 1095.25bn at the end of May .This is further corroborated by weakness in call money rates, whose average fell from 7.83% in April to 5.83% in May.

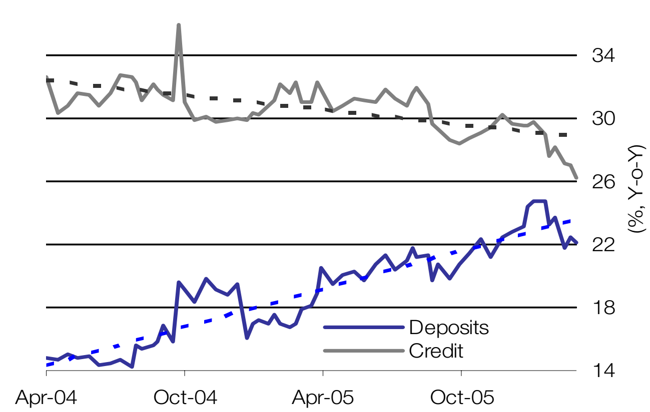
Reverse repo bids on the rise



Source: RBI

- Both deposit and credit growth slowed down in May. Deposit growth decreased to 22.1% from 22.5% as on May 25. Credit numbers stood at 26.3% Y-o-Y for the fortnight ended May 25.

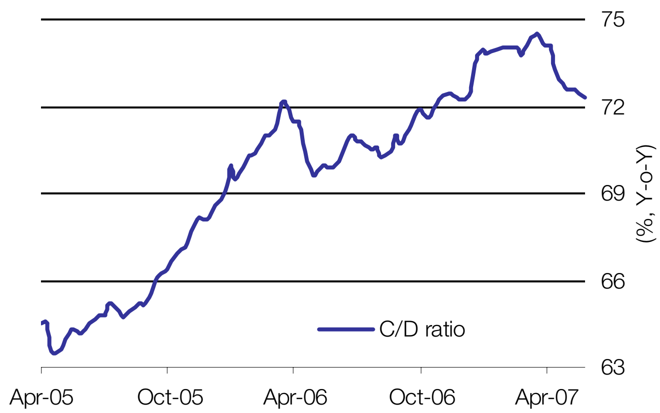
Credit growth & deposit growth slow down



Source: Bloomberg, RBI

- Credit deposit ratio for the fortnight ended may 25 stood at 72.32%.In comparison to the last fortnight it was at 72.62%.It has been declining since the beginning of FY-08.it stood at 74.13% for the week ended April 6.

C-D Ratio declines

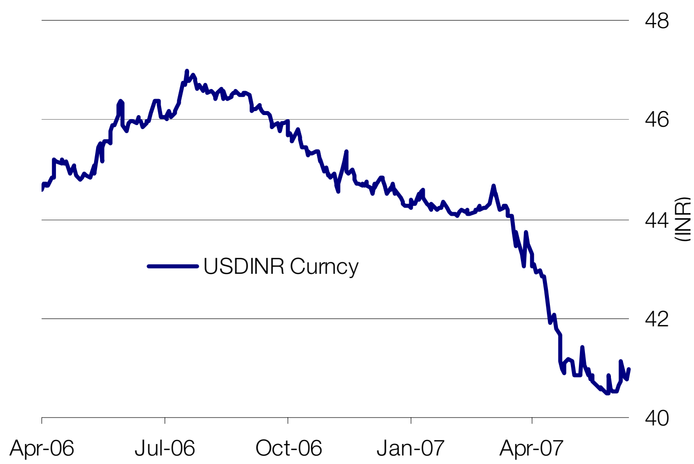


Source: Bloomberg

* External sector in focus

- The USD/INR exchange rate appreciated further in May to USD/INR 40.57 in comparison with USD/INR 41.2 in March. We expect some depreciation in the rupee going forward, based on a rise in the trade deficit and RBI intervention

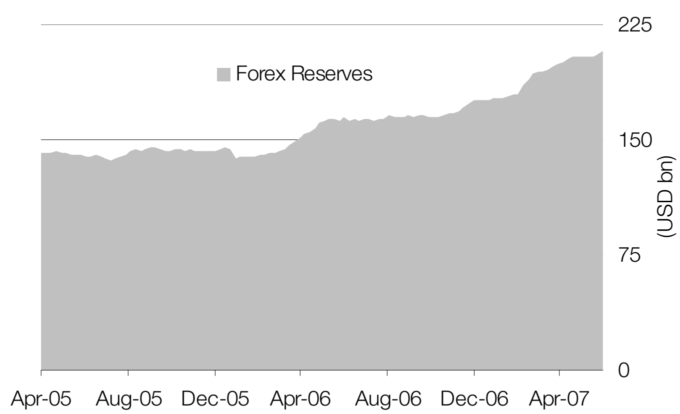
Exchange rate appreciates in May



Source: Bloomberg

- The forex kitty surged to USD 208 bn on Jun 1 – an increase of USD 3.4 bn over the previous week. This is indicative of recent RBI intervention in the currency markets.

Forex kitty strong



Source: Bloomberg, RBI

Economy datasheet	Jun-06	Jul-06	Aug-06	Sep-06	Oct-06	Nov-06	Dec-06	Jan-07	Feb-07	Mar-07	Apr-07	May-07
Industrial production												
IIP (%,Y-o-Y)	9.7	13.2	10.3	12.0	4.5	15.8	13.4	11.6	10.8	14.5	13.6	
Mining	4.7	5.1	(1.7)	4.3	5.9	8.8	6.1	7.7	7.1	7.3	3.4	
Electricity, gas and water supply	4.9	8.9	4.1	11.3	9.7	8.7	9.1	8.3	3.3	7.9	8.7	
Manufacturing	10.7	14.3	11.9	12.7	3.8	17.2	14.5	12.3	11.9	15.9	15.1	
Use based												
Basic goods	8.5	10.0	4.8	11.5	10.5	12.1	12.4	12.0	10.6	11.7	8.9	
Capital goods	21.6	18.3	16.6	9.5	6.5	29.4	26.2	16.3	18.5	18.2	17.7	
Intermediate goods	11.2	10.7	8.7	13.8	5.9	17.9	12.7	13.7	12.2	14.3	12.6	
Consumer goods	6.1	16.8	15.0	12.1	-2.8	13.5	10.7	8.2	7.6	16.0	17.7	
Infrastructure indicators												
Infrastructure index (%,Y-o-Y)	7.7	10.8	6.5	10.5	9.8	9.5	8.5	8.2	7.5	10.0	7.4	
Electricity	4.9	8.9	4.1	11.5	9.7	8.7	9.3	8.5	3.3	8.0	8.7	
Coal	12.0	10.6	0.2	(0.7)	2.1	4.9	2.9	10.0	6.6	10.7	0.5	
Steel	10.2	13.9	9.3	10.4	10.4	9.1	10.0	8.3	13.4	14.6	8.4	
Cement	11.7	14.0	2.9	16.5	9.4	11.8	8.0	7.2	5.8	5.5	5.1	
Crude petroleum	1.2	4.1	12.1	9.4	9.3	9.8	10.7	4.7	4.9	3.2	1.4	
Refined petroleum	10.6	12.6	12.1	13.4	18.1	16.4	6.2	9.2	11.3	13.4	15.2	
GSM subscribers (in mn)	78.5	82.4	86.6	91.0	95.7	100.8	105.4	110.4	115.3	121.4	125.6	
Railways goods traffic,rev. (INR bn)	32.6	31.1	32.0	33.6	36.1	37.4	38.4	35.7	41.0	41.0	36.2	
Inflation												
WPI (%,Y-o-Y)	5.0	4.6	4.8	5.2	5.1	5.3	5.4	6.2	6.4	6.3	5.9	5.2
Primary articles	6.9	4.5	6.1	7.9	6.7	6.7	8.6	9.7	11.6	11.6	11.7	9.9
Fuel, light, power and lubricants	8.6	7.4	5.9	5.0	5.5	5.3	3.6	3.7	1.8	1.2	1.1	0.6
Manufactured products	2.9	3.6	3.8	4.1	4.3	4.8	4.8	5.8	6.2	6.4	5.6	5.1
CPI, IW (%,Y-o-Y)	7.9	6.9	6.0	6.8	7.6	6.7	6.7	7.6	6.7	6.7		
Government finances												
Fiscal deficit, cumulative (INR bn)	777	864	951	865	871	1,082	948	1,110	1,218	1,428	278	
Monetary indicators												
Money supply (M3) (%,Y-o-Y)	18.1	19.5	19.7	19.1	18.6	19.4	19.4	21.1	21.8	20.7	19.8	19.6
Bank credit (INR bn)	15,451	15,569	15,861	16,547	16,556	16,837	17,663	17,806	18,202	19,232	18,896	18,865
Food credit	380	361	364	335	366	387	422	421	439	465	499	449
Non-food credit	15,071	15,208	15,498	16,213	16,189	16,451	17,242	17,386	17,763	18,767	18,397	18,417
Credit-deposit ratio	70.8	70.6	71.0	71.9	72.2	72.2	74.0	74.0	73.8	74.1	72.7	72.3
External sector												
Foreign trade												
Exports (USD bn)	10.0	10.2	10.4	10.3	9.6	9.7	9.9	9.6	9.7	12.5	10.6	
Imports (USD bn)	13.8	14.1	13.8	15.6	15.7	15.8	15.6	15.4	14.4	16.4	17.6	
Trade balance (USD bn)	(3.6)	(4.0)	(4.1)	(6.0)	(6.9)	(5.4)	(5.7)	(5.8)	(4.7)	(3.8)	(7.1)	
Forex reserves (USD bn)	163	164	166	167	167	176	177	181	195	199	204	205

Source: Bloomberg, CGA, CMIE, Ministry of Commerce and Industry, Edelweiss estimates

	Q2FY06	Q3FY06	Q4FY06	Q1FY07	Q2FY07	Q3FY07	Q4FY07
Real indicators							
GDP (% Y-o-Y)	8.4	7.5	9.3	8.9	9.2	8.6	9.1
Agriculture & allied products	4.0	2.9	5.5	3.4	1.7	1.5	3.8
Industry	7.8	8.1	8.9	9.7	10.3	9.95	11.2
Services	10.0	9.4	10.9	10.6	10.9	11.26	9.9
WPI (% Y-o-Y)	4.0	4.5	4.0				
External sector							
Current account balance (USDbn)	(5.1)	(3.9)	1.8	(6.0)	(6.9)	(3.0)	
Trade balance (USD bn)	(14.6)	(12.0)	(11.4)	(18.4)	(17.9)	(19.0)	(14.3)
Invisible balance (USD bn)	9.6	8.2	13.3	12.4	11.0	16.0	
Capital account balance (USD bn)	9.9	(0.6)	11.4	11.8	8.6	10.7	

Source: CMIE,RBI

Edelweiss Securities
14th Floor, Express Towers,
Nariman Point, Mumbai – 400 021
Board: (91-22) 2286 4400
Email: *research@edelcap.com*

Naresh Kothari – 2286 4246	Co-Head, Institutional Equities
Vikas Khemani – 2286 4206	Co-Head, Institutional Equities

INDIA RESEARCH			SECTOR
Shriram Iyer	-	2286 4256	Head – Research
Gautam Roy	-	2286 4305	Airlines, Textile
Ashutosh Goel	-	2286 4287	Automobiles, Auto Components
Vishal Goyal, CFA	-	2286 4370	Banking & Finance
Revathi Myneni	-	2286 4413	Cement
Harish Sharma	-	2286 4307	Infrastructure, Auto Components, Mid Caps
Priyanko Panja	-	2286 4300	Infrastructure, Engineering, Telecom
Parul Inamdar	-	2286 4355	Information Technology
Priyank Singhal	-	2286 4302	Media, Retail, FMCG
Prakash Kapadia	-	4097 9843	Mid Caps
Niraj Mansingka	-	2286 4304	Oil & Gas, Petrochemicals
Manika Premsingh	-	4019 4847	Economist
Sunil Jain	-	2286 4308	Alternative & Quantitative
Yogesh Radke	-	2286 4328	Alternative & Quantitative

INSTITUTIONAL SALES		
Nischal Maheshwari	-	2286 4205
Rajesh Makharia	-	2286 4202
Vikrant Oak	-	4019 4712
Abhijit Chakraborty	-	4019 4823
Balakumar V	-	(044) 4263 8283
Ashish Agrawal	-	2286 4301
Nikhil Garg	-	2286 4282
Swati Khemani	-	2286 4266
Neha Shahra	-	2286 4276
Priya Ramchandran	-	2286 4389
Anubhav Kanodia	-	2286 4361
Tushar Mahajan	-	2286 4439
Harsh Biyani	-	2286 4419
Nirmal Ajmera	-	2286 4258
Ankit Doshi	-	2286 4671
Dipesh Shah	-	2286 4434

Email addresses: firstname.lastname@edelcap.com **e.g.** naresh.kothari@edelcap.com *unless otherwise specified*

RATING INTERPRETATION

Buy	Expected to appreciate more than 20% over a 12-month period	Reduce	Expected to depreciate up to 10% over a 12-month period
Accumulate	Expected to appreciate up to 20% over a 12-month period	Sell	Expected to depreciate more than 10% over a 12-month period
Trading Buy	Expected to appreciate more than 10% over a 45-day period	Trading Sell	Expected to depreciate more than 10% over a 45-day period