Outlook For Indian Economy

ICRIER Macro Group*

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19 September 2008

Growth Forecasts 2008-09

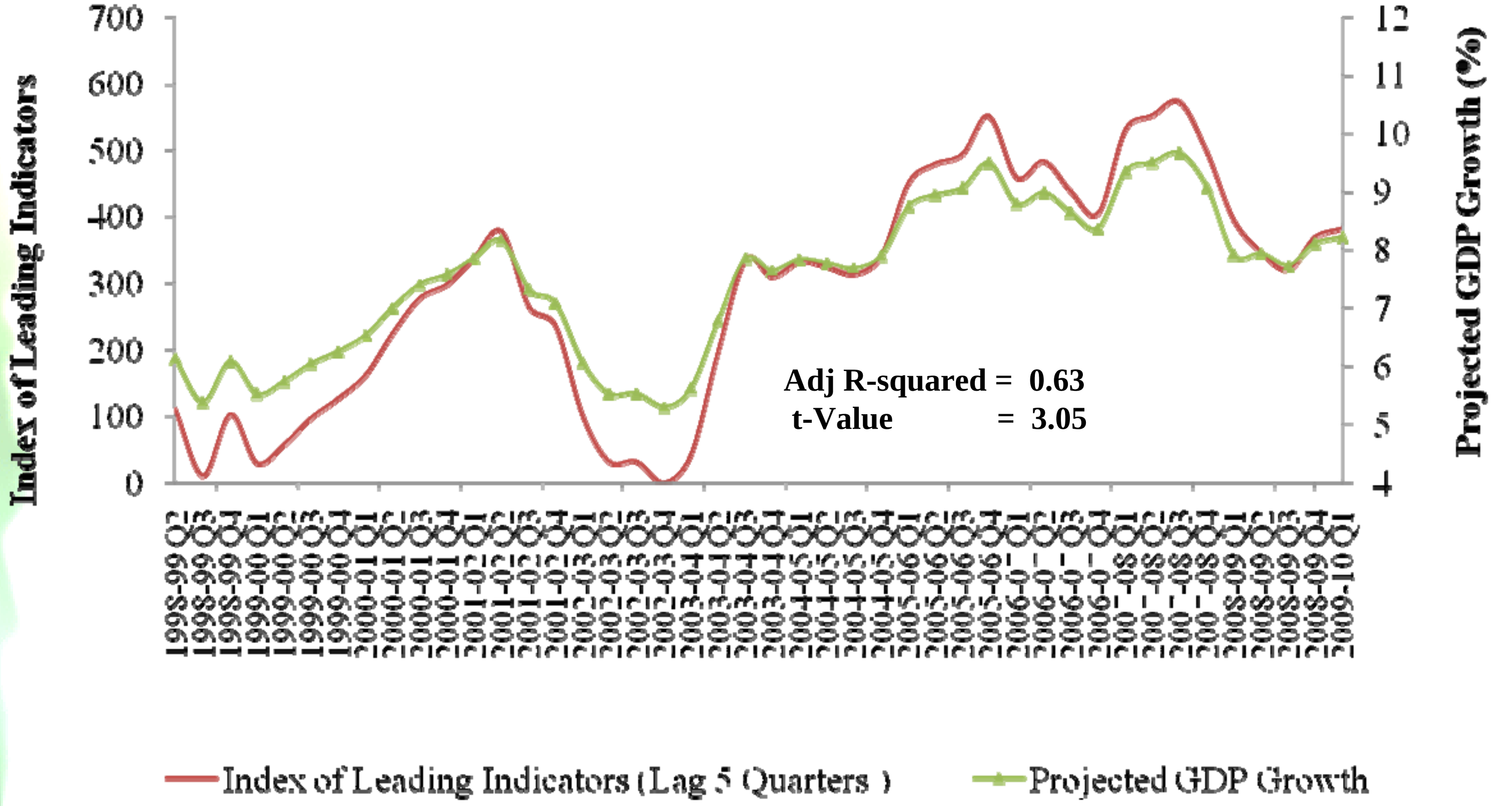
Index of Leading Economic Indicators (ILD)

- LEIs consist of:
  - Production of machinery & equipment
  - Sales of heavy commercial vehicles
  - Non-food credit
  - Railway freight traffic
  - Cement sales
  - Corporate performance (sales)
  - Fuel & metal prices
  - Real interest rate

- Composite quarterly index for 1997-2008
  - Principal component index approach

- 5-quarter lag between ILD and growth rate

Projection of Growth Rate through Index of Leading Indicators

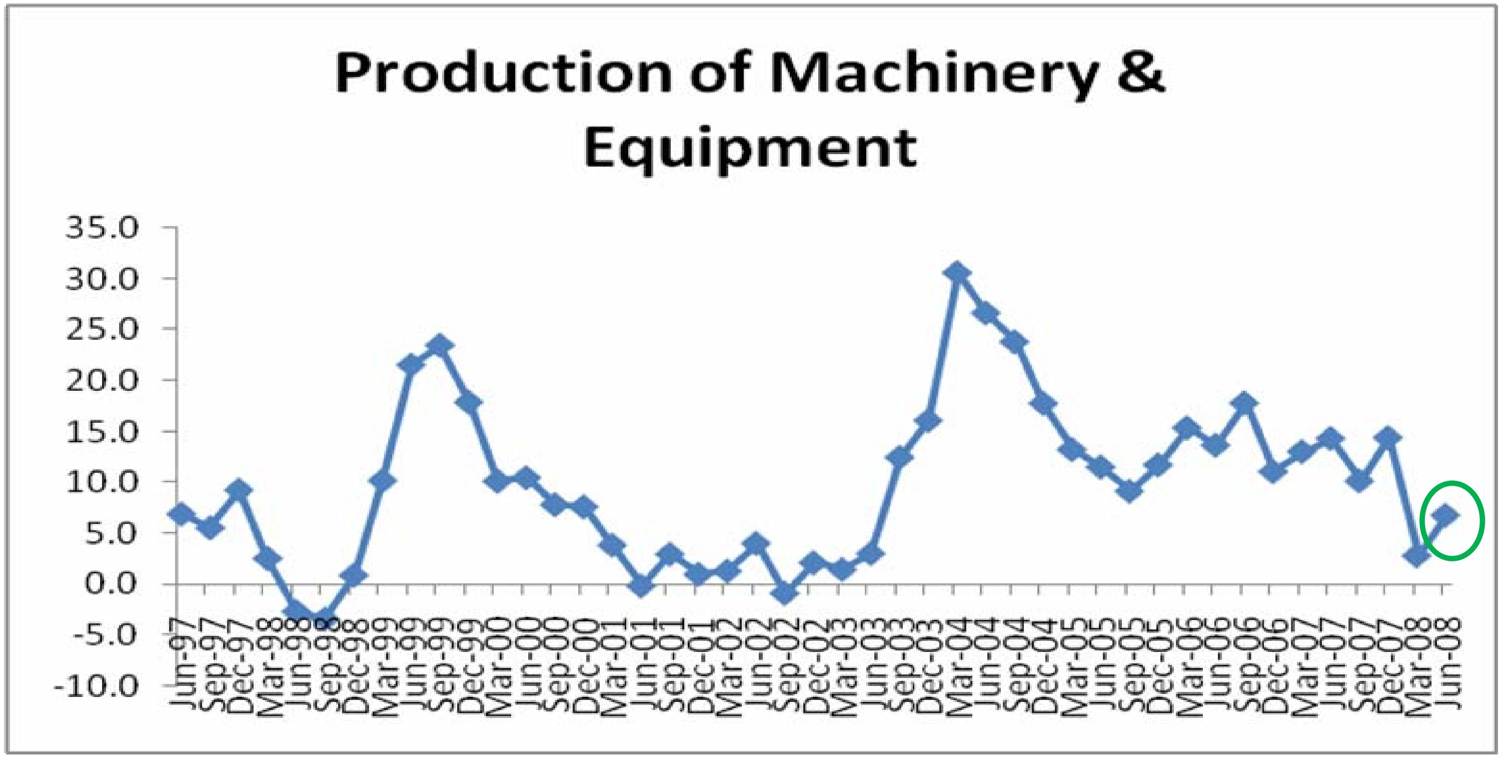


•*ILD forecasts a growth rate at 7.9 per cent for 2008-09*

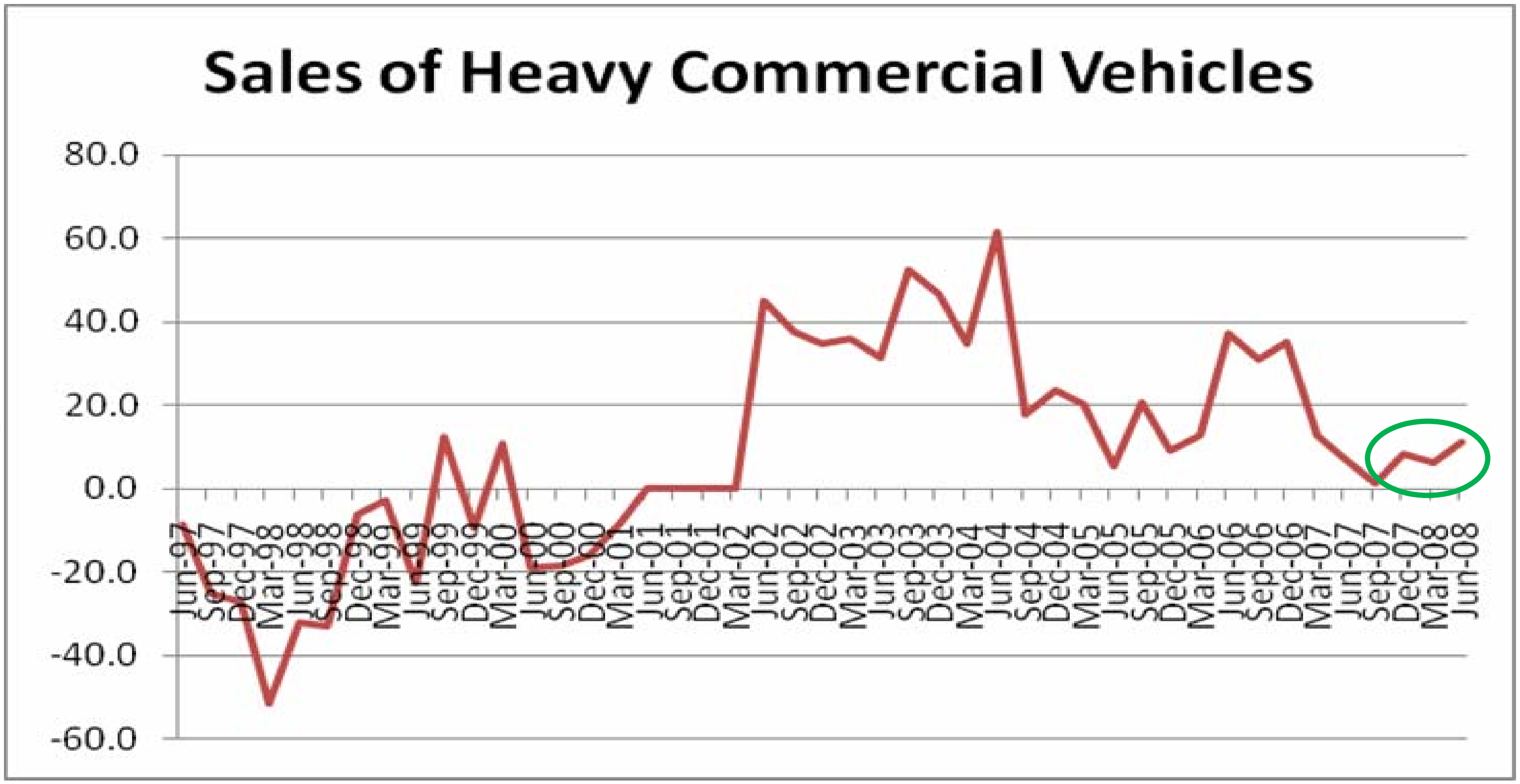
•*Growth rate to rise to 8.2 % for 2009-10Q1*

4

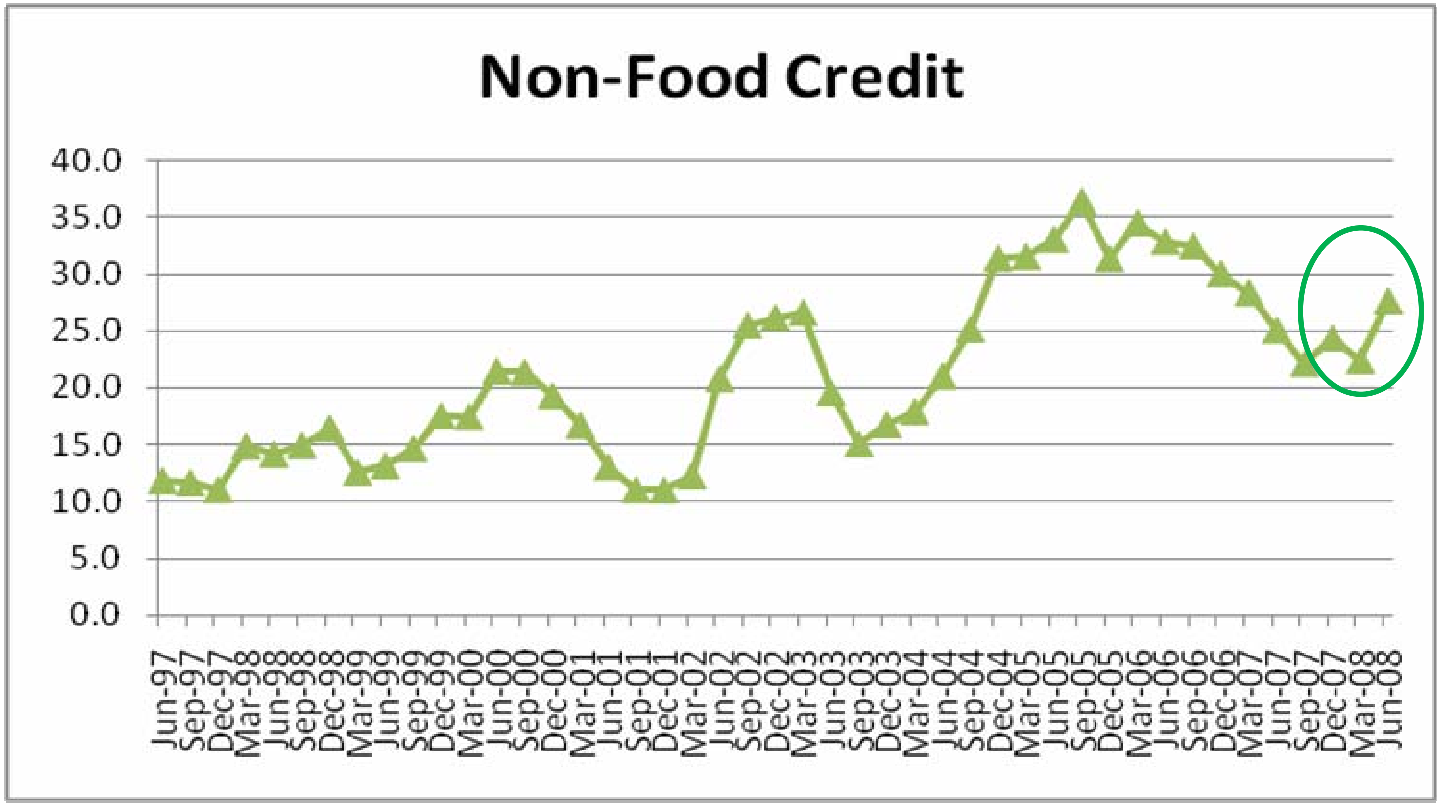
Trends in Leading Indicators



Trends in Leading Indicators…



Trends in Leading Indicators…



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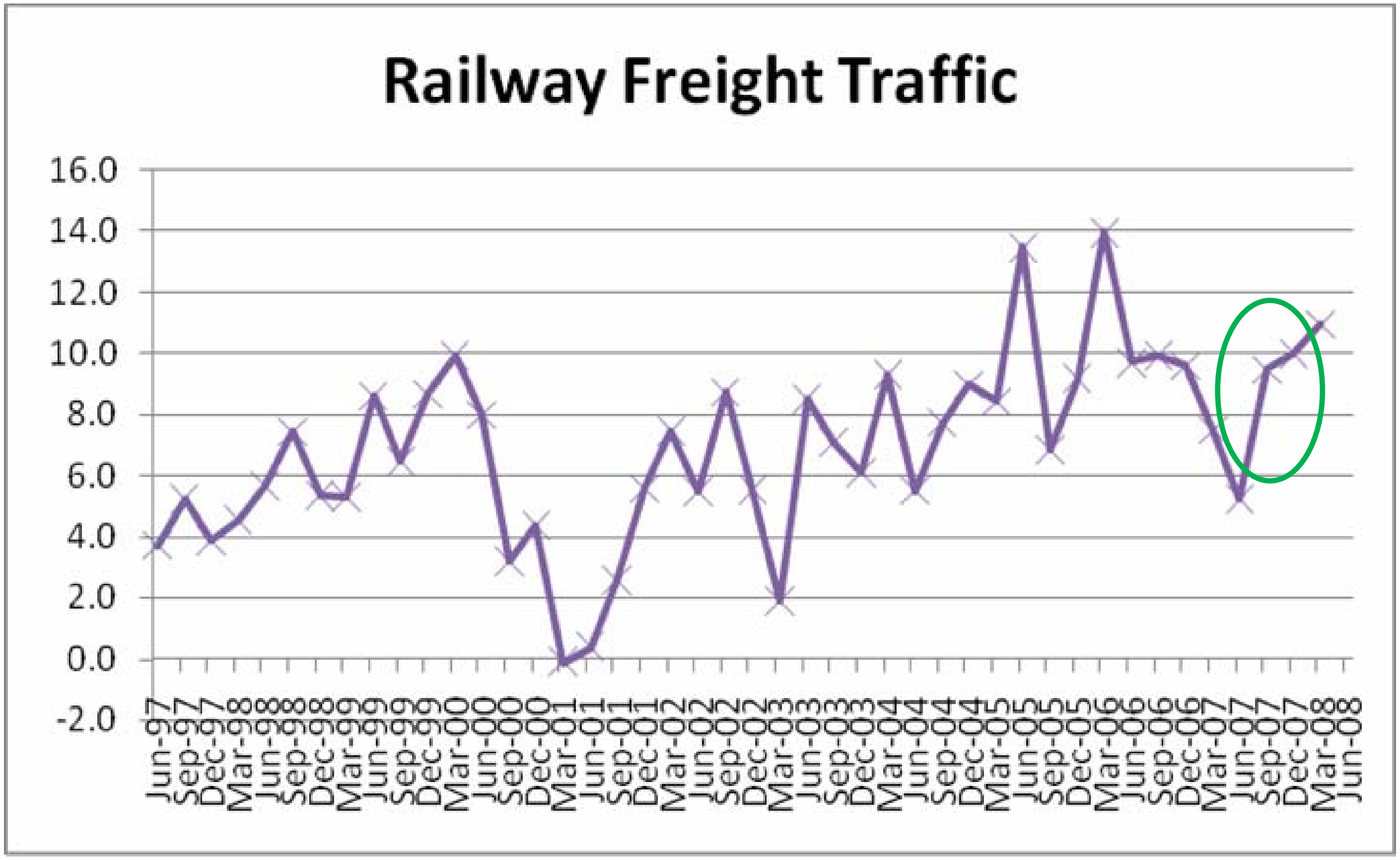

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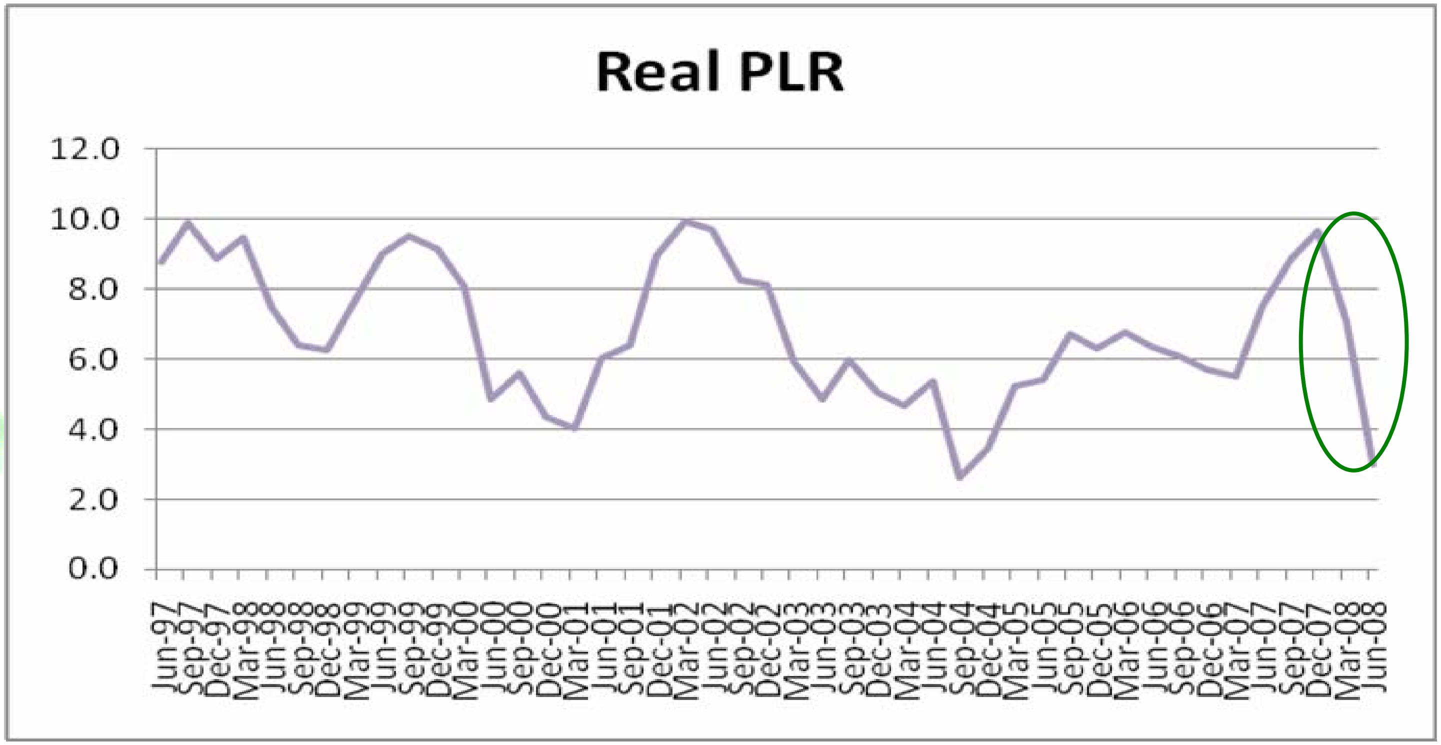
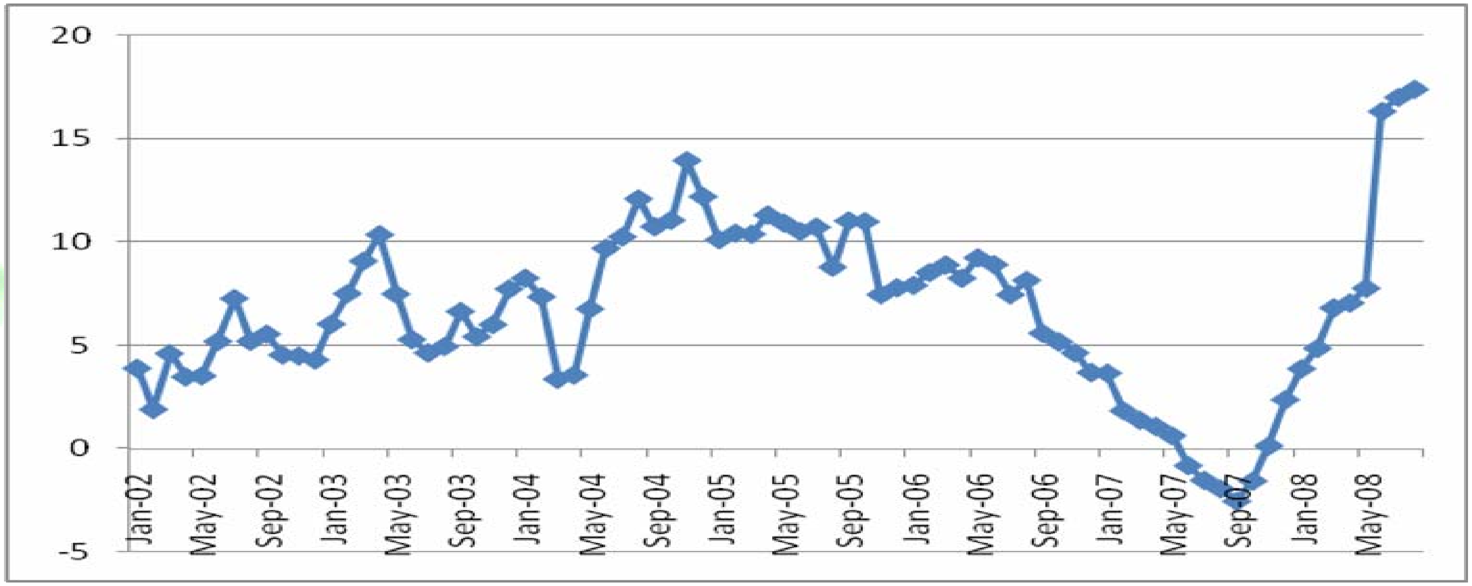


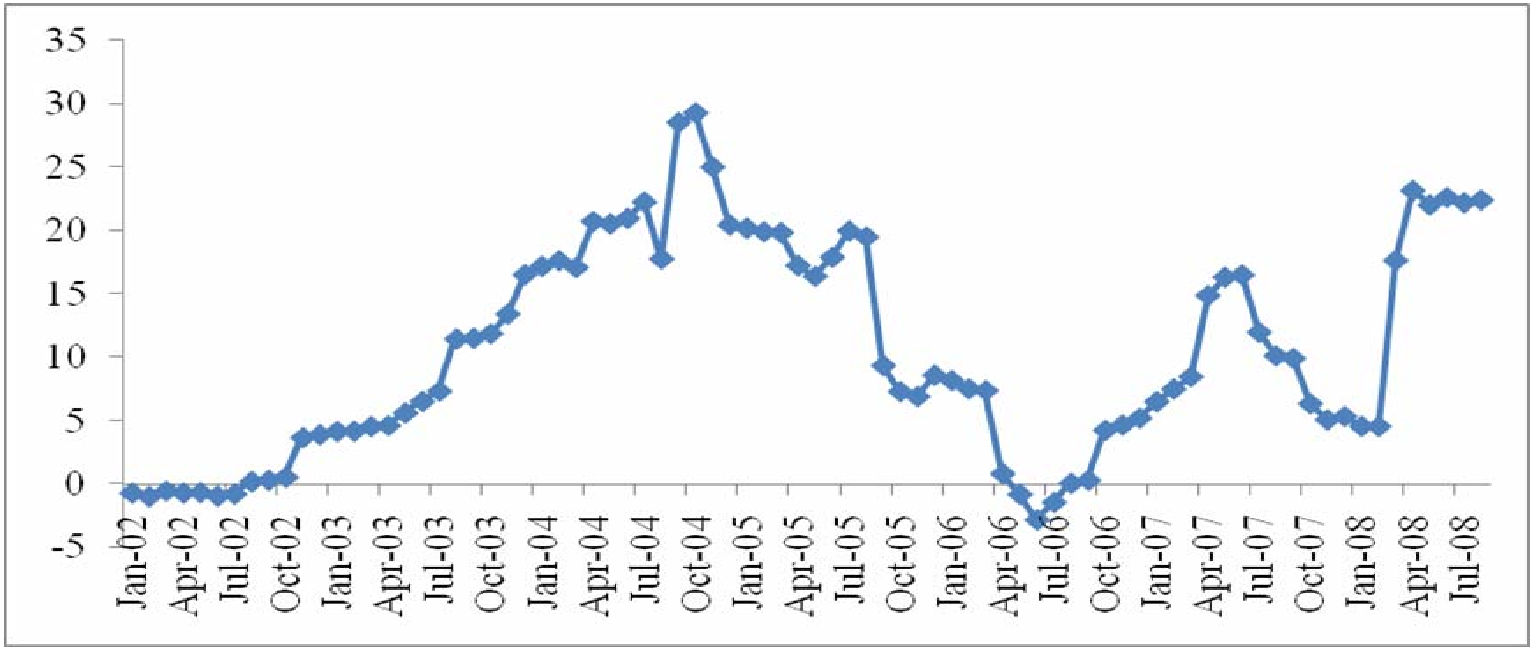
Trends in Leading Indicators…

Fuel Inflation



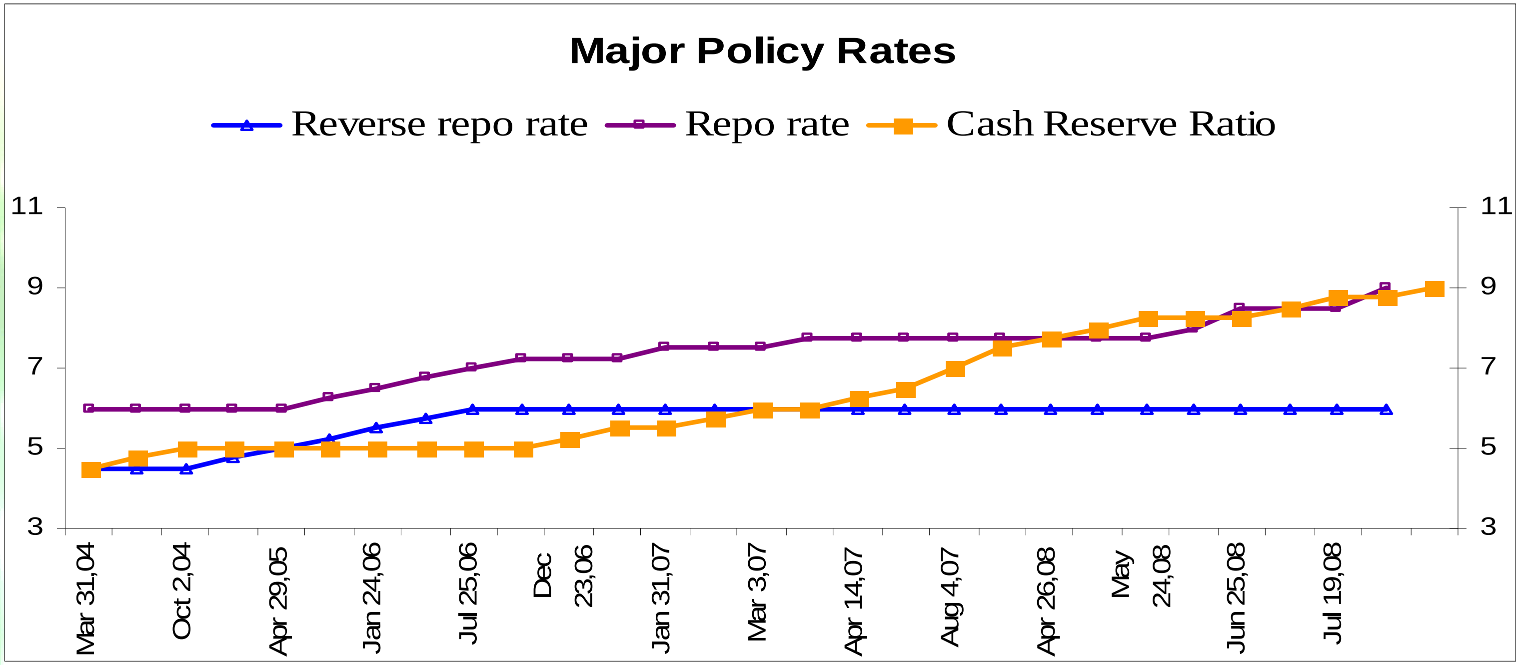
Trends in Leading Indicators…

Inflation of Basic Metals



2009-10 Scenario

- Pick up seen in Q1 2009-10 but may not be sustained
  - Impact of monetary policy tightening yet to work itself out

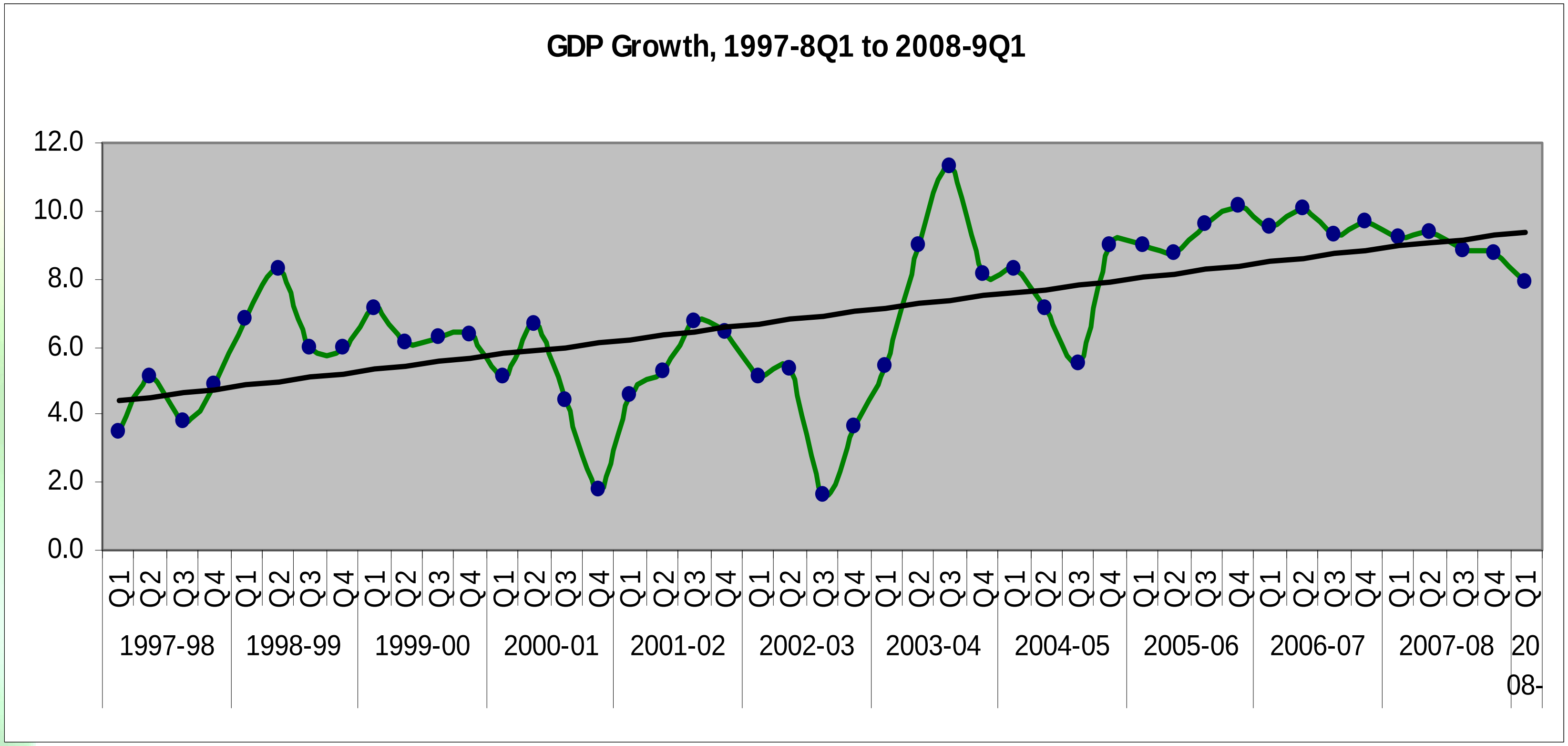


- In addition, a number of downside risks

Downside Risks

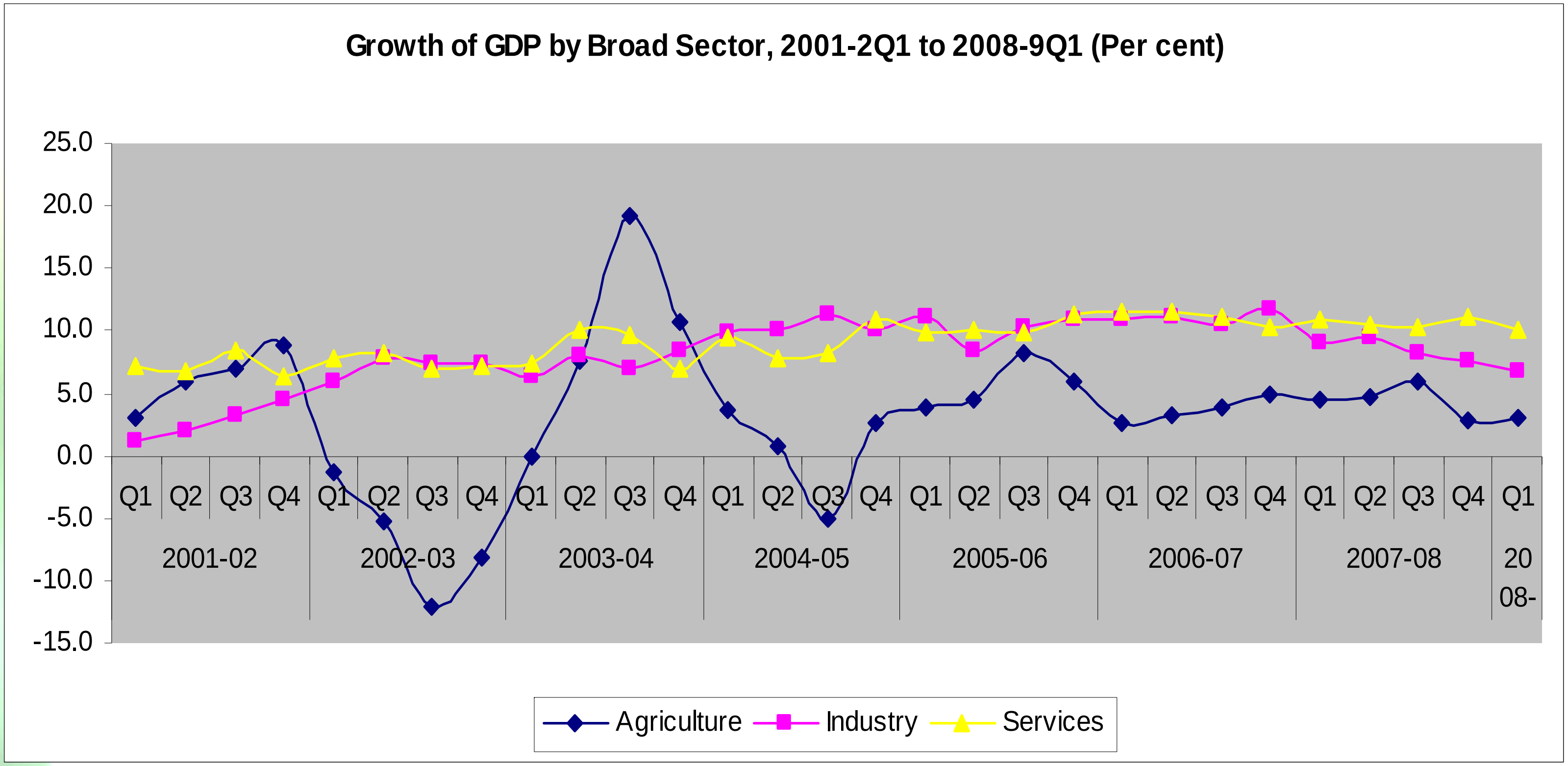
1. Downtrends in Growth

Quarterly GDP Growth Trends



Last 3 quarter growth rates below trend

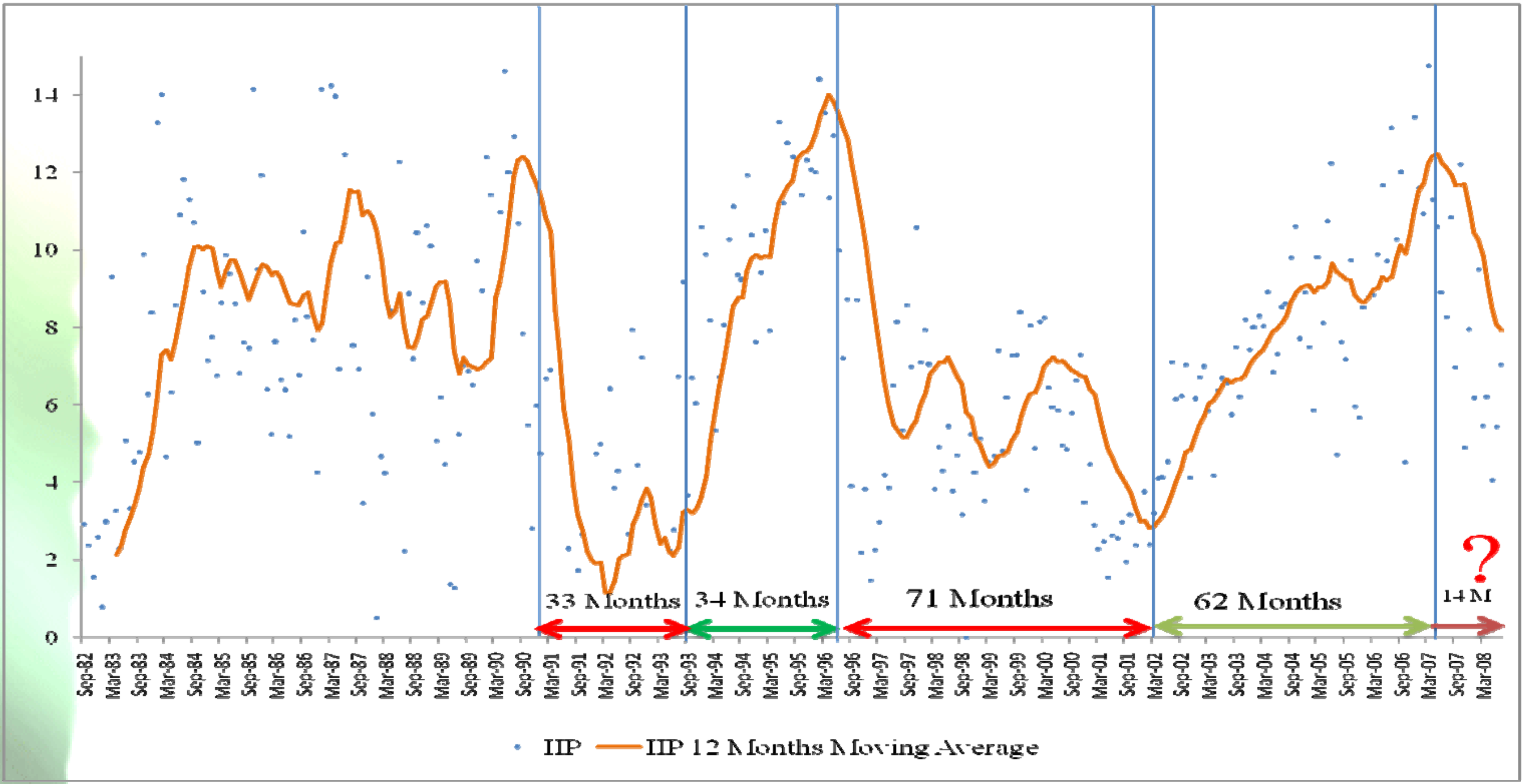
Quarterly Growth Rates by Broad Sector



- *Weakening industrial growth since Q4 2006-07*
- *Moderation in services growth since Q2 2006-07*
- *Positive but low growth for agriculture*

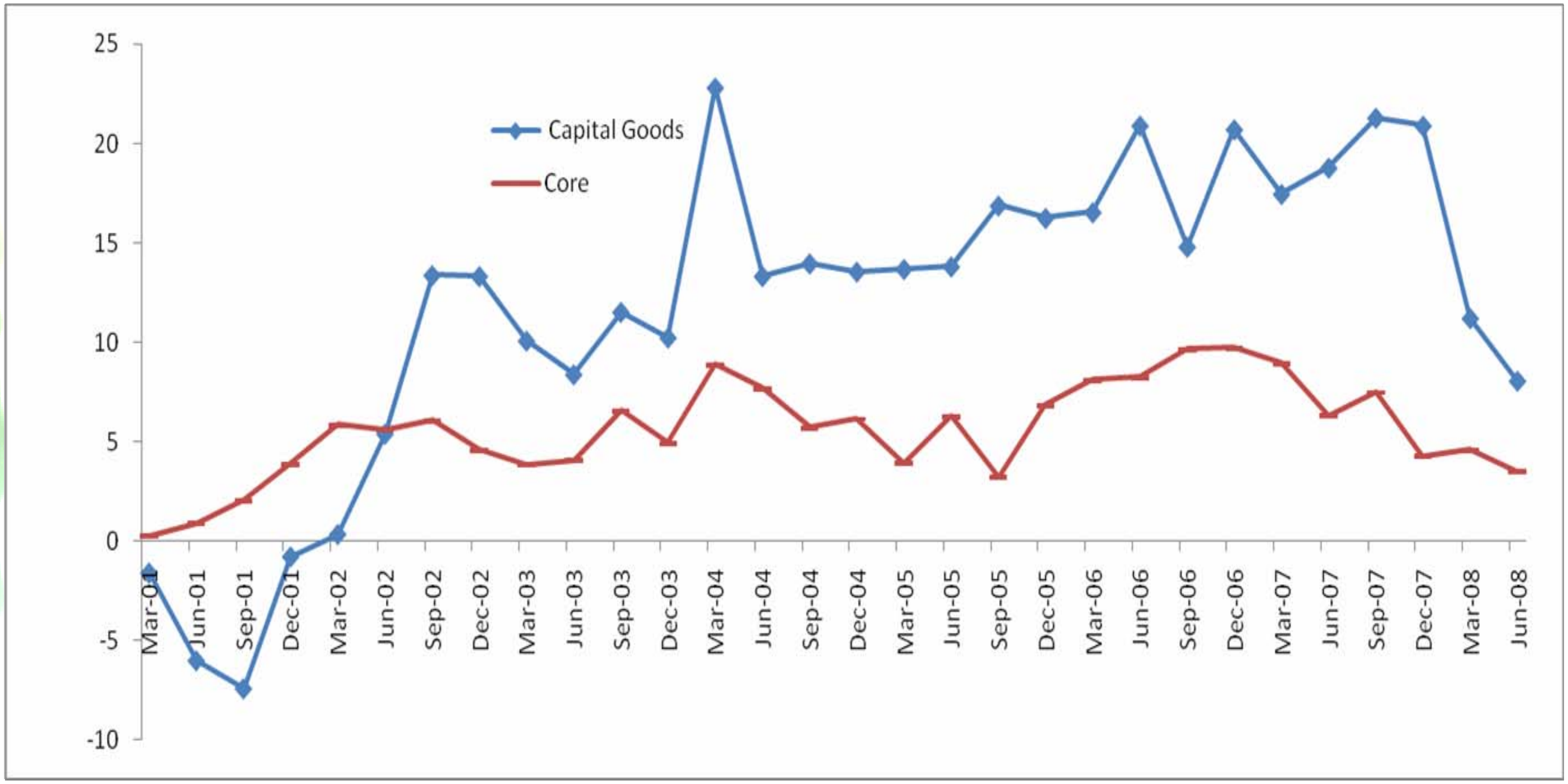
2. Industrial Sector Weakness

Growth of IIP
(1982-2008)



- *Previous downturns lasting 3 to 5 years!*
- *What about this time?*

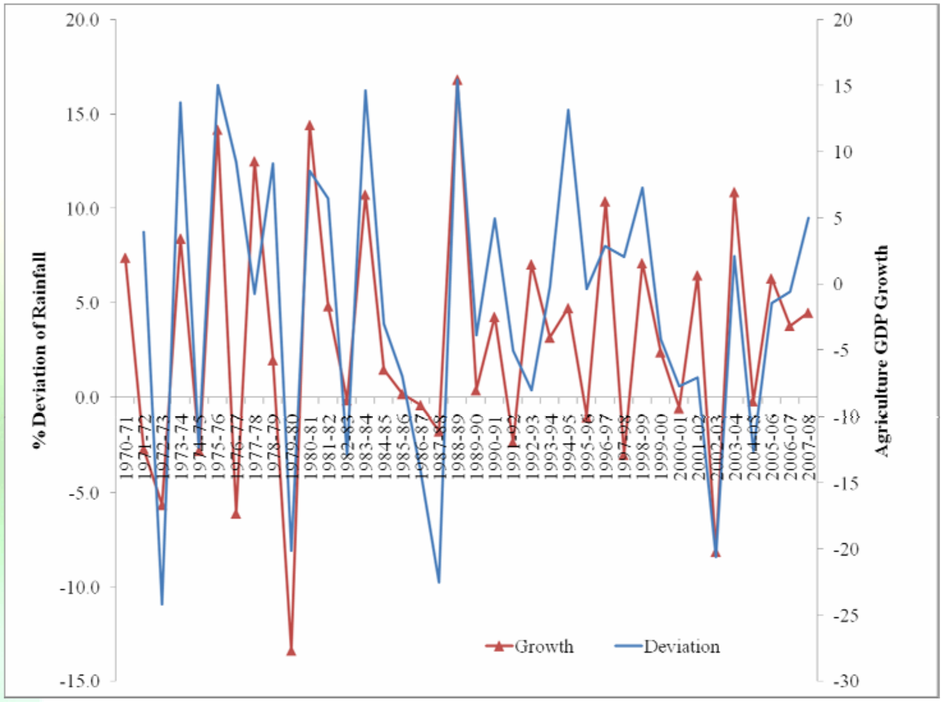
Growth of Capital Goods and Core Sector Industries

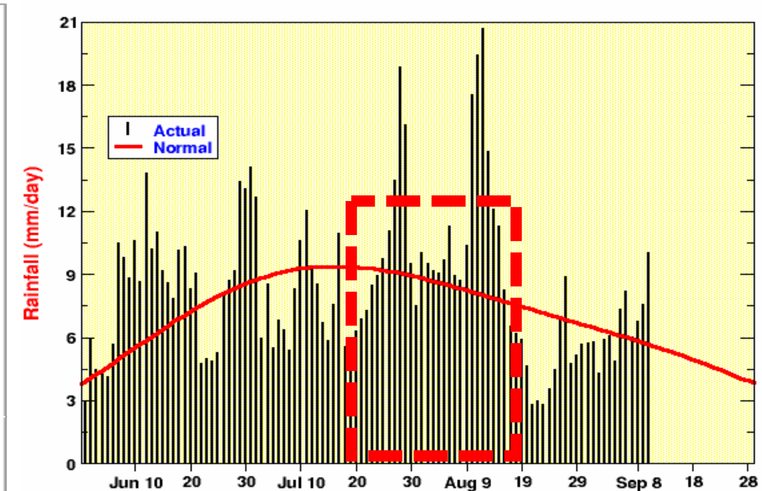


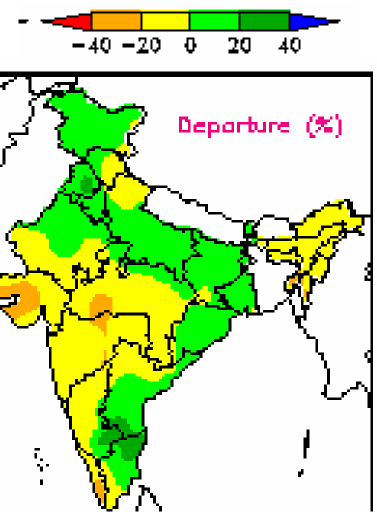
- *Sharp fall in capital goods production growth since Q3 2007-8*
- *Low core sector growth since Q2 2007-8*

3. Monsoon and Agriculture

Monsoon and Agriculture Growth



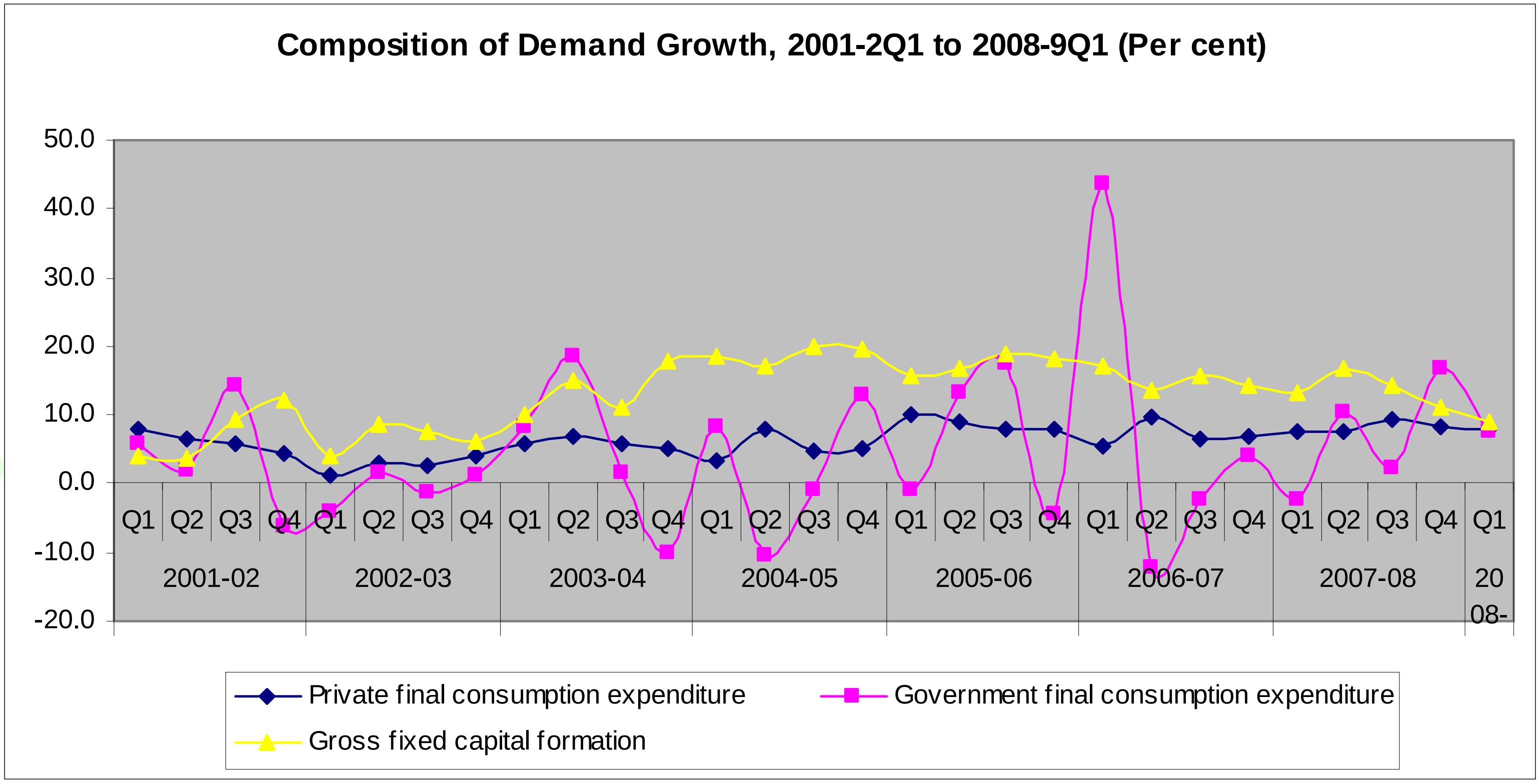




- *Agriculture growth closely follows monsoon*
- *Normal monsoon during the critical weeks this year*
- *Spatial and temporal distribution not satisfactory*

4. Investment Weakness

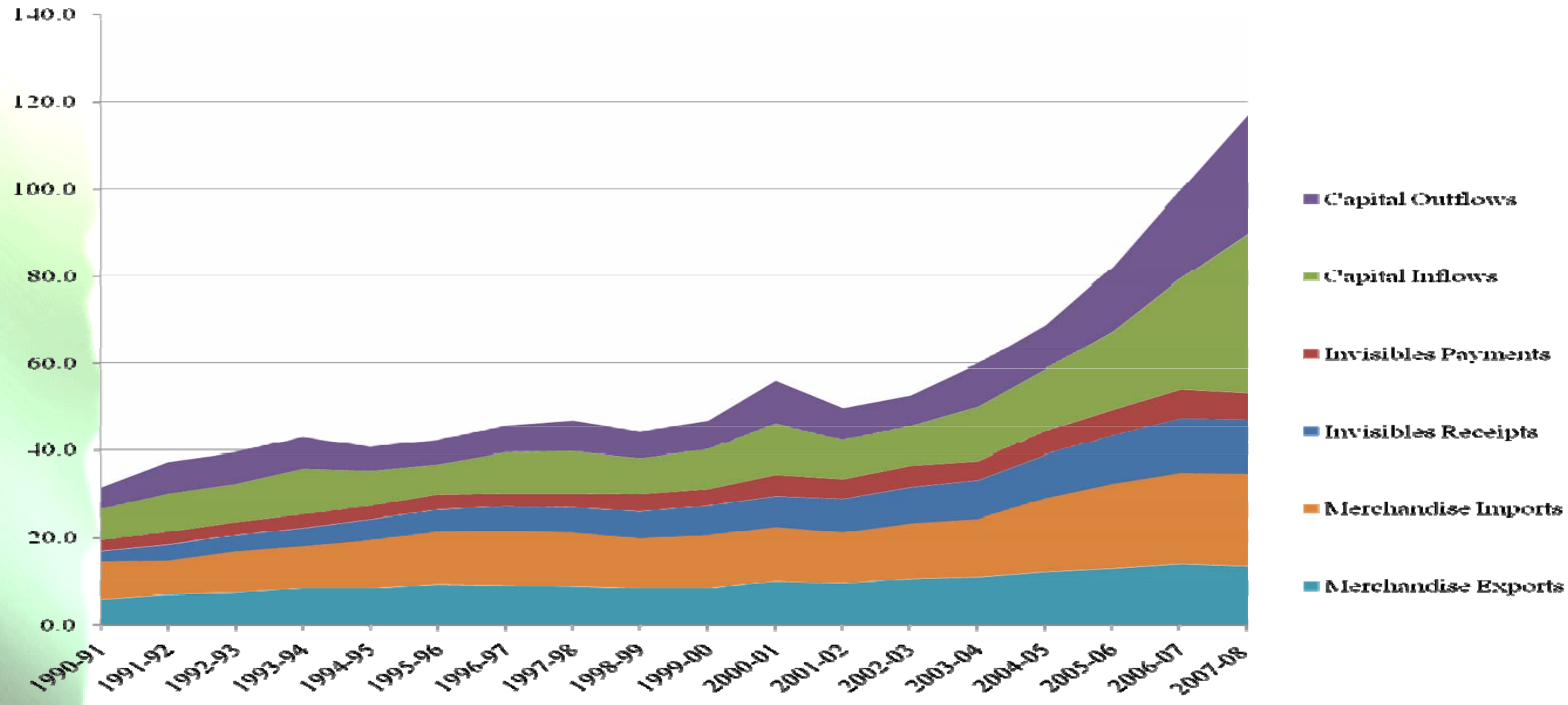
Composition of Quarterly Demand Growth



- *Private consumption expenditure steadily growing at 8-9%, but fixed investment growth falling steadily in last 3 quarters*
- *Government consumption expenditure subject to large swings*

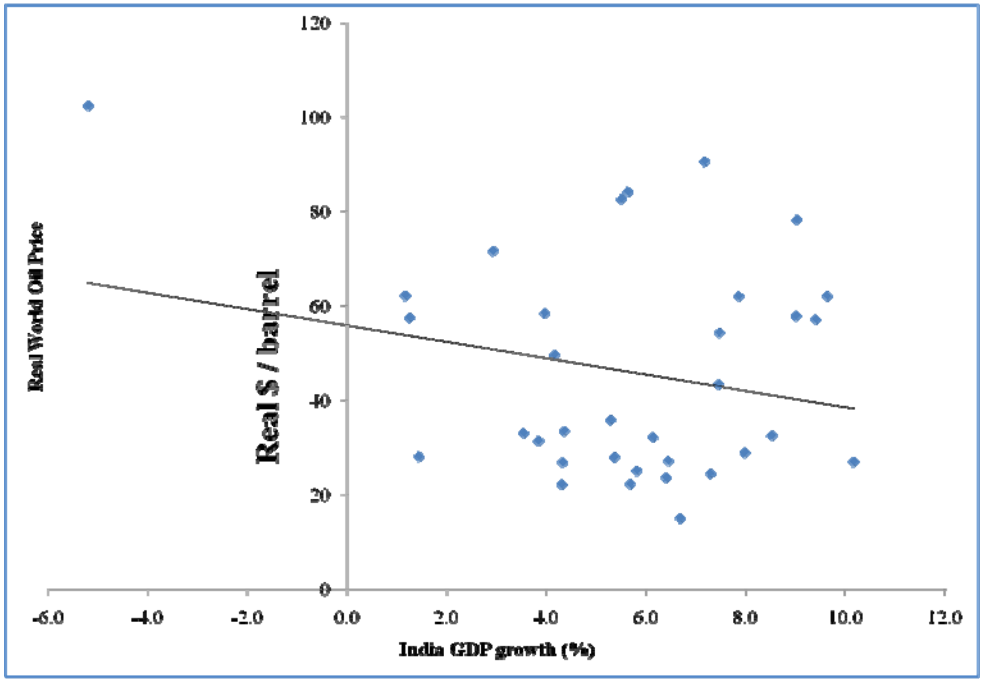
5. Global Environment

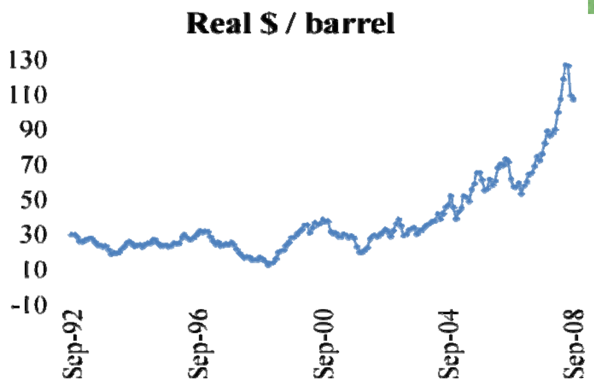
Global Integration
(Current Account & Capital Account as a % GDP)



- *Current account transactions rising from less than 20% of GDP to 50%*
- *Both current and capital account transactions from less than a third of GDP to over 115%*

World Oil Price and India's GDP Growth (1974-2008)



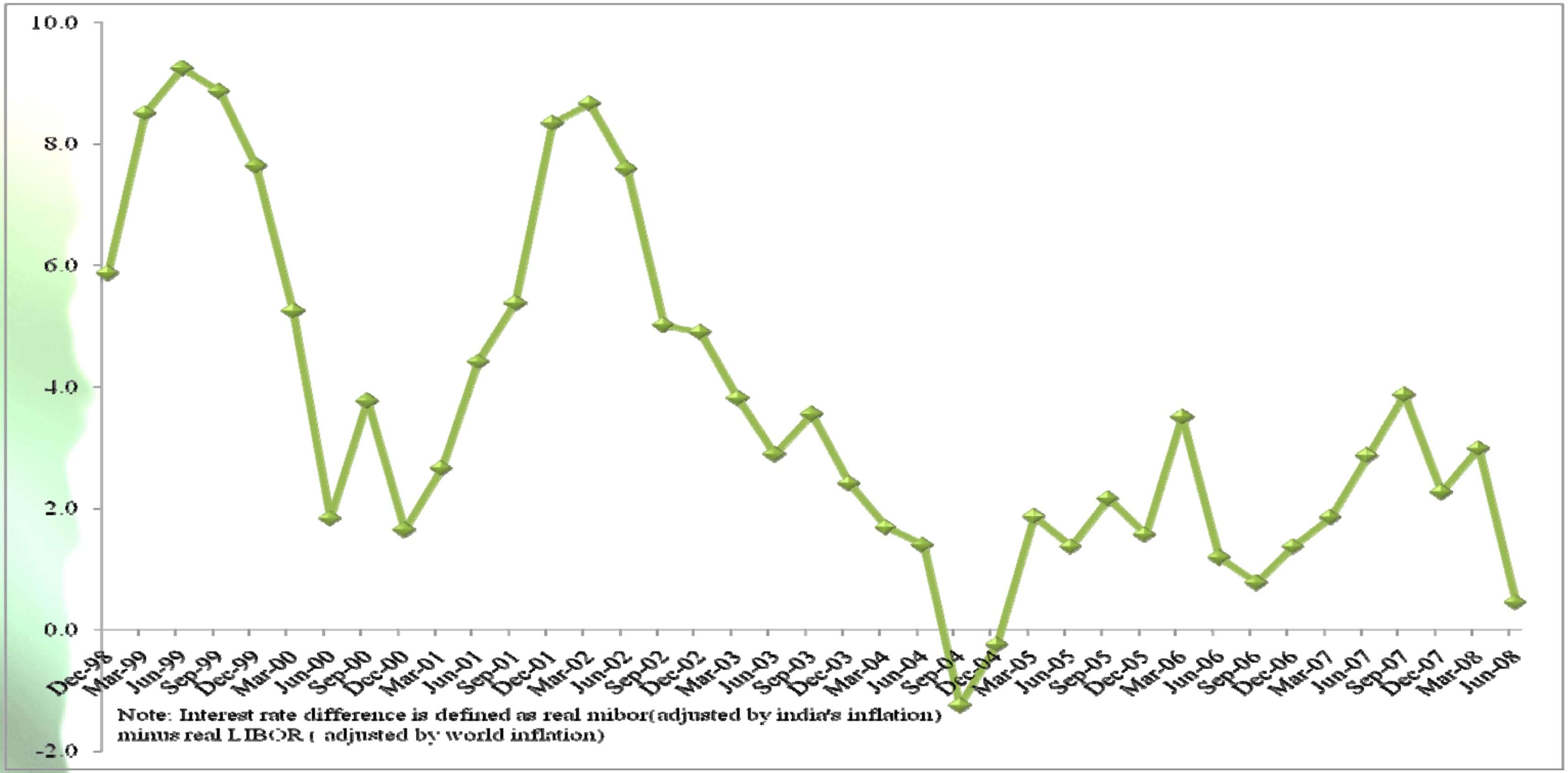


Futures Price	
	Average
Oct-08	93.2
Nov-08	93.2
Dec-08	93.5
Jan-09	93.7
Feb-08	94.0
Mar-09	93.5

Inverse relationship with world oil price

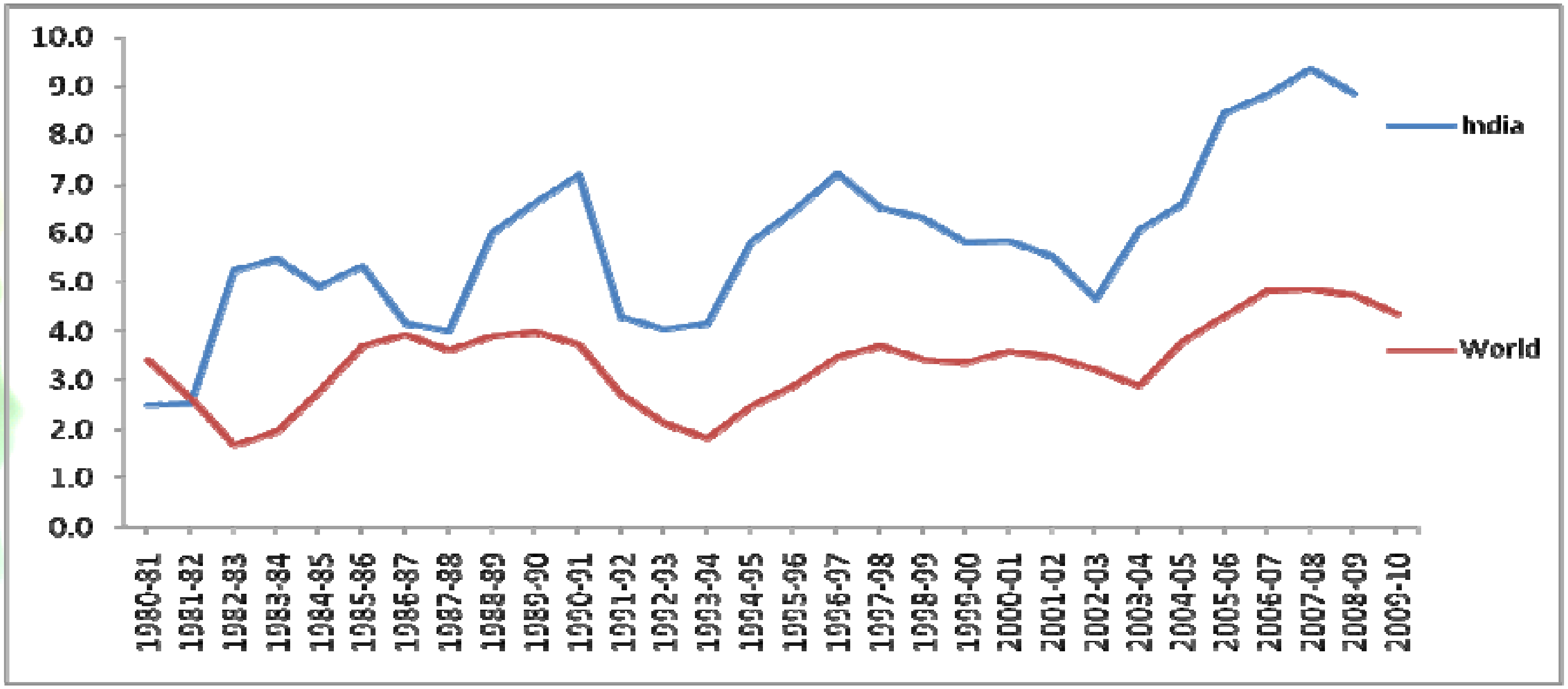
Source: www.nymex.com

Real Interest Rate Differential with Developed Economies (1999-2008)



Narrowing of the real interest rate differential reversing portfolio capital flows?

GDP Growth: India & World
(3-Year Moving Average)



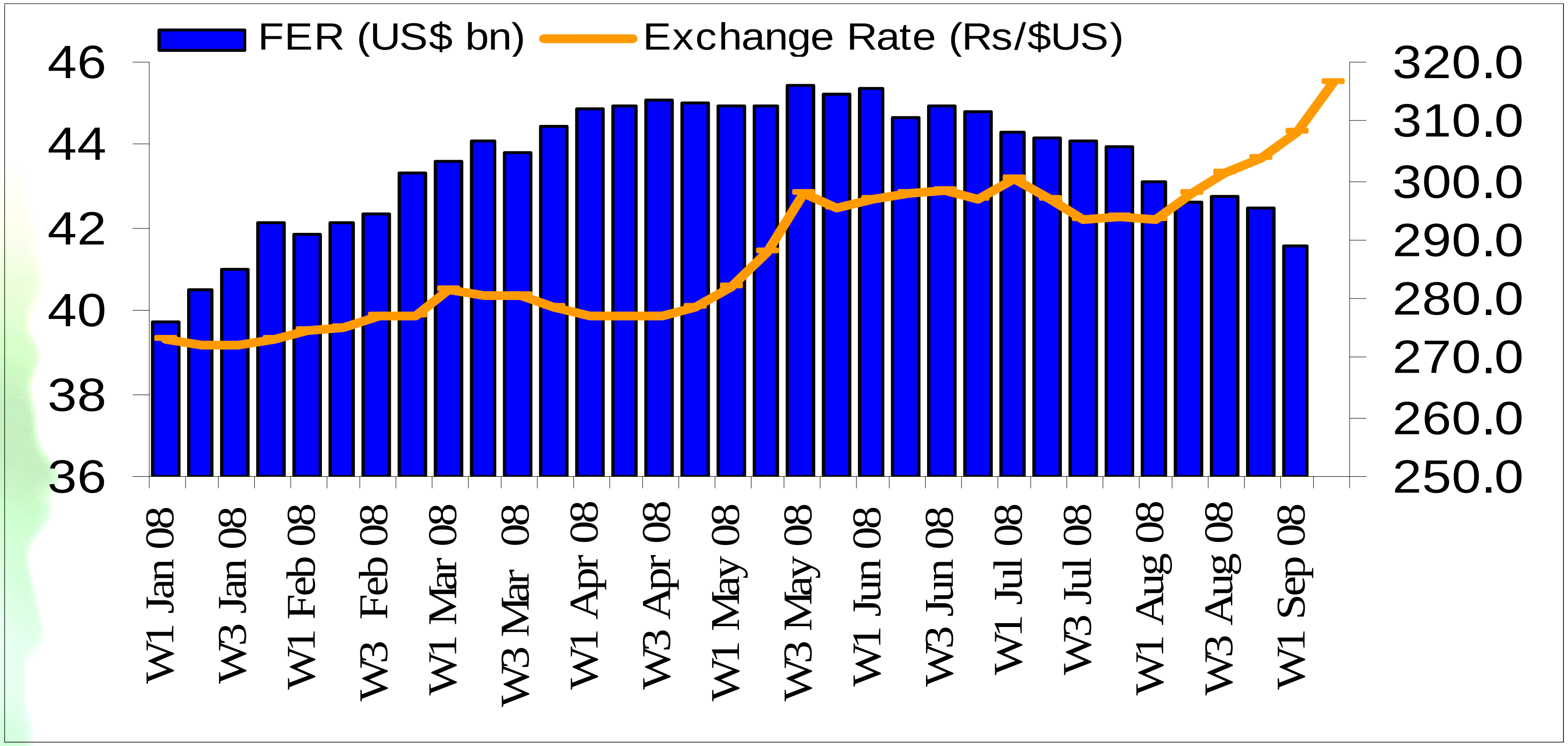
- *Indian and world growth clearly correlated*
- *Less benign external environment*

India's Balance of Payments: Base Scenario			
	2006-07	2007-08	2008-09(P)
Exports	128083	158461	197429
Imports	191254	248521	330562
Trade balance	-63171	-90060	-133133
% of GDP	**-6.9**	**-7.7**	**-10.7**
Invisible receipts	115074	145257	167046
Invisible payments	61669	72600	83490
Invisibles, net	53405	72657	83556
% of GDP	**5.8**	**6.2**	**6.7**
Current account	-9766	-17403	-49577
% of GDP	**-1.1**	**-1.5**	**-4.0**
Capital account (net)	46372	109567	29000
% of GDP	**5.1**	**9.4**	**2.3**
-Foreign direct investment	8479	15545	20000
-Portfolio investment	7062	29261	-10000
-External commercial borrowings	16155	22165	10000
-Short-term trade credit	6612	17683	5000
-External assistance	1767	2114	2500
-NRI deposits	4321	179	1500
-Other banking capital	-2408	11578	0
-Other flows	4384	11042	0
Change in Reserves (-increase. +decline)	**-36606**	**-92164**	**20577**
Note: Crude oil price at $110 per barrel in 2008-9 against $79 in 2007-8.			

Assumptions: Non- oil exports rise by 18%, non-oil imports by 25%, remittances and software exports rises by 10%

- *Trade deficit to deteriorate to nearly 11% of GDP and current account deficit to rise sharply to 4.0% of GDP*
- *Capital account surplus to shrink substantially and reserve drawdown above $20 billion*

Forex Reserves & Exchange Rate



- *Foreign reserves fell by US$ 21 billion FY09 up to Sep 5 against a rise of US$ 31 billion in the same period FY08*
- *Rupee depreciated by 12% this FY up to Sep 12, against an appreciation of 8% in the same period last year*

India's Balance of Payments: Pessimistic Scenario			
	2006-07	2007-08	2008-09(P)
Exports	128083	158461	197429
Imports	191254	248521	330562
Trade balance	-63171	-90060	-133133
% of GDP	**-6.9**	**-7.7**	**-10.7**
Invisible receipts	115074	145257	159783
Invisible payments	61669	72600	83490
Invisibles, net	53405	72657	76293
% of GDP	**5.8**	**6.2**	**6.1**
Current account	-9766	-17403	-56840
% of GDP	**-1.1**	**-1.5**	**-4.6**
Capital account (net)	46372	109567	10000
% of GDP	**5.1**	**9.4**	**0.8**
-Foreign direct investment	8479	15545	18000
-Portfolio investment	7062	29261	-15000
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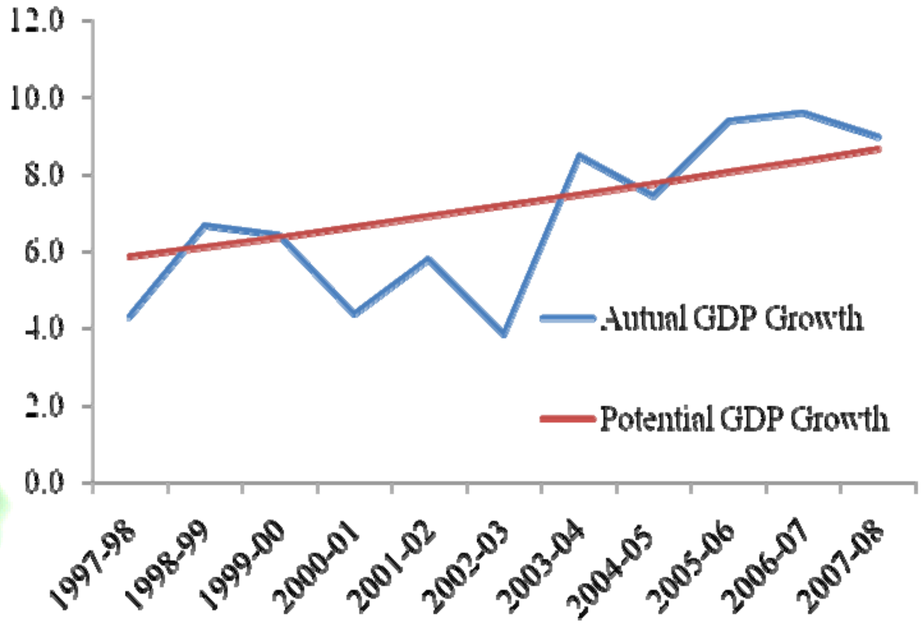
-Other banking capital	-2408	11578	-5000
-Other flows	4384	11042	0
Change in Reserves (-increase. +decline)	**-36606**	**-92164**	**44840**
Note: Crude oil price at $110 per barrel in 2008-9 against $79 in 2007-8.			

Assumptions: Non- oil exports rise by 18%, non-oil imports by 25%, remittances no growth and software exports rises by 7%

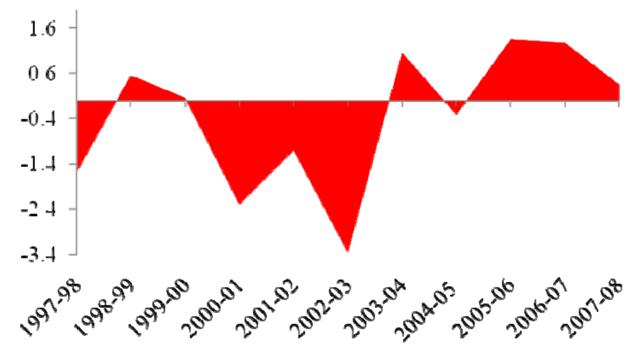
- *Current account deficit to rise to 4.6% of GDP*
- *Capital account surplus to shrink further and reserve drawdown nearly $45 billion*

6. Inflation & Policy Response

Potential GDP Growth and Output Gap (1997-8 to 2007-8)



Output Gap %



Potential output growth: 8.7% in 2007-08

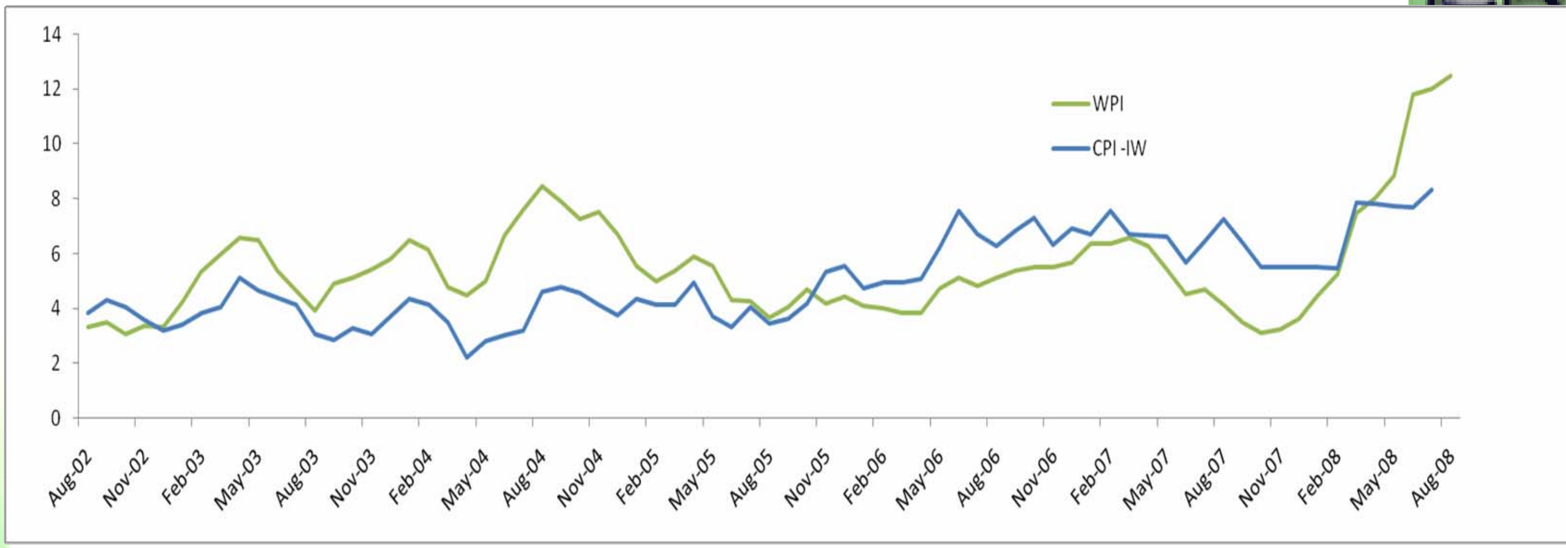
8.4% in 2006-07

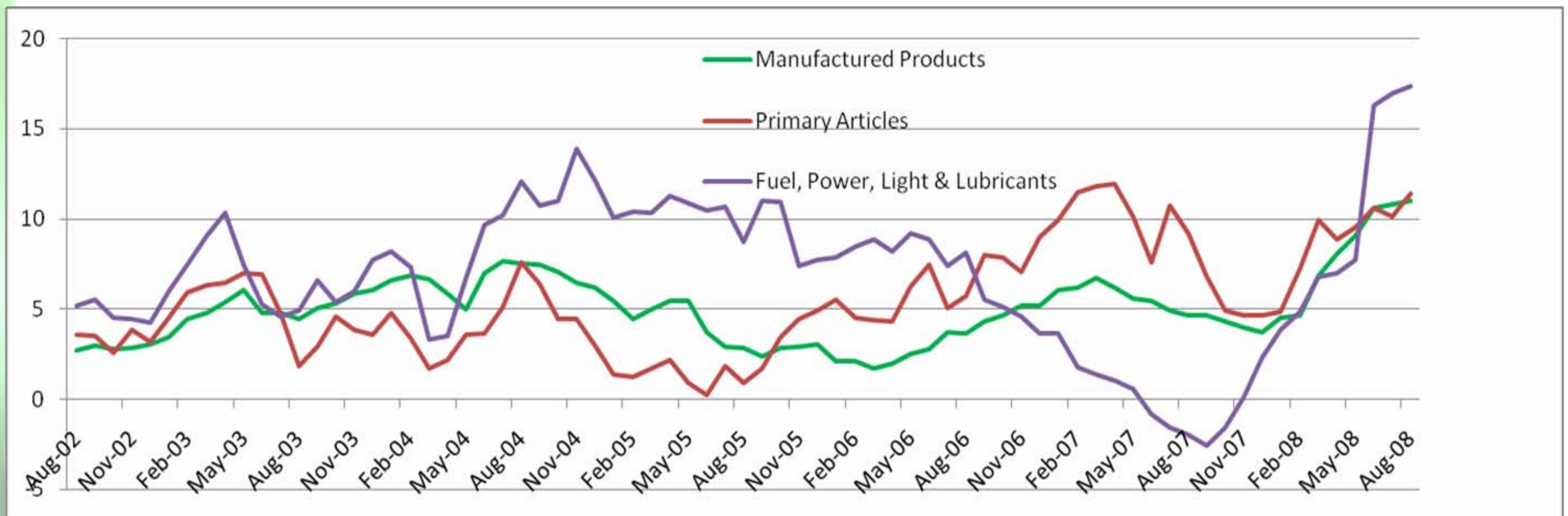
8.1% in 2005-06

Note: HP filter technique as proposed by Hodrick and Prescott (1997)

Tightening of monetary policy aimed to narrow output gap

WPI Inflation Analysis





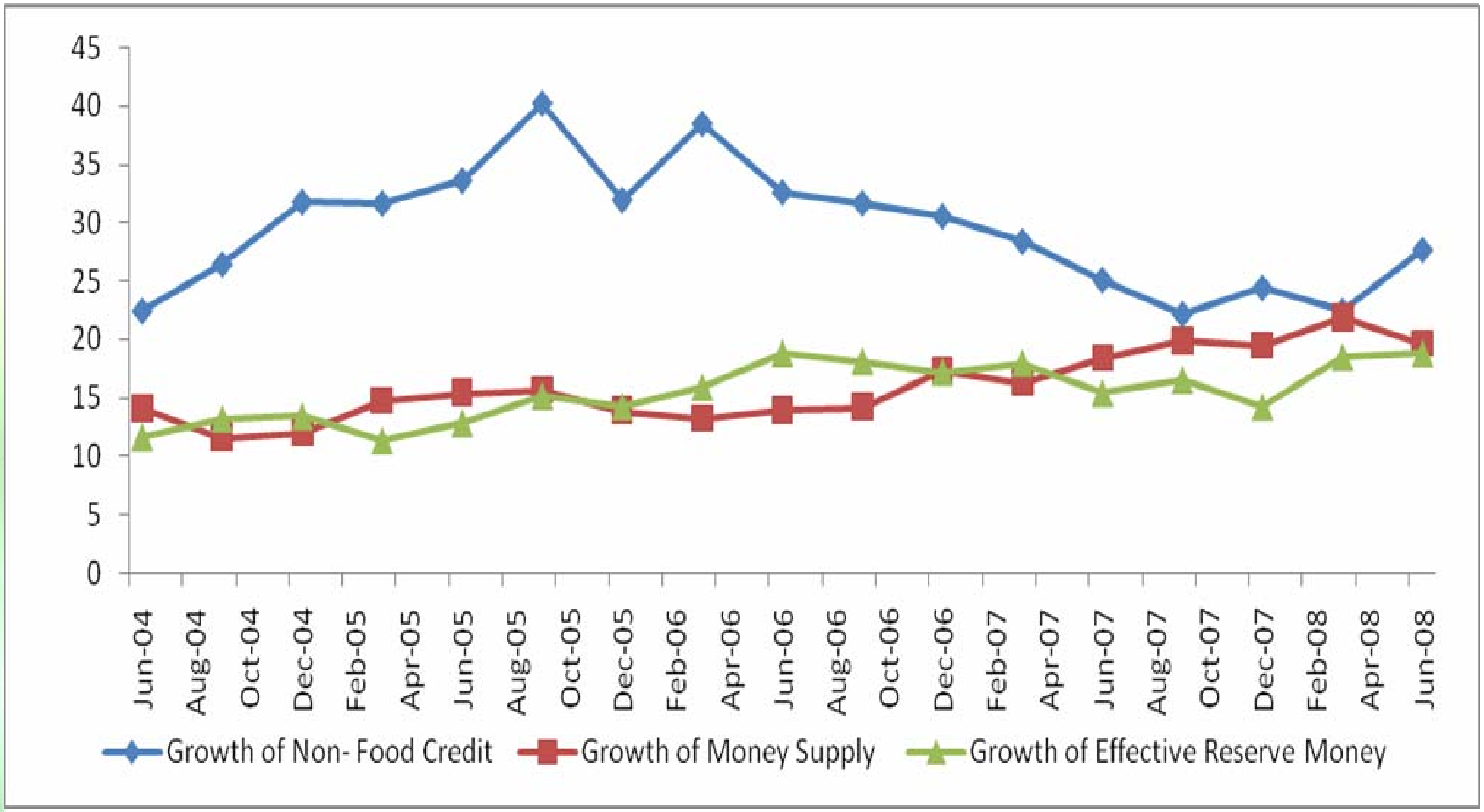
Inflation in fuel sector much higher than in the other two sectors

% Inflation Contribution

	Fuel, Power, Light & Lubricants	Manufactured Products (Excl Iron & Steel, Edible oil)	Iron & Steel	Edible Oil	Primary Articles (Excl Raw cotton, Oil seeds, Iron ore)	Iron Ore	Raw Cotton	Oil Seeds	WPI
Weight	**14.2**	**56.2**	**4.8**	**2.8**	**17.8**	**0.2**	**1.4**	**2.7**	**100**
Jan-07	7.9	39.9	12.8	6.1	22.9	0.4	-0.4	10.4	100
Feb-07	3.8	36.0	16.3	6.3	23.5	0.6	1.2	12.2	100
Mar-07	2.7	37.9	16.9	5.8	21.3	0.7	2.6	12.1	100
Apr-07	2.2	42.0	10.1	6.6	21.5	0.5	4.2	12.9	100
May-07	1.5	42.7	10.6	7.1	19.5	0.5	4.0	14.0	100
Jun-07	-2.4	49.2	11.2	8.9	9.8	0.5	5.5	17.4	100
Jul-07	-4.2	42.6	7.7	9.2	20.8	0.3	5.9	17.7	100
Aug-07	-5.9	48.3	6.2	8.5	20.6	0.0	4.0	18.4	100
Sep-07	-8.9	54.5	9.5	8.6	11.2	0.1	4.4	20.6	100
Oct-07	-6.2	58.0	8.2	10.0	3.7	0.0	5.3	20.9	100
Nov-07	0.5	53.4	8.0	9.5	5.6	0.0	5.6	17.3	100
Dec-07	9.0	48.2	7.8	7.5	7.9	0.3	7.0	12.2	100
Jan-08	12.1	49.5	7.7	7.0	6.0	0.8	7.4	9.5	100
Feb-08	13.1	41.2	8.1	7.1	13.4	2.3	5.7	9.1	100
Mar-08	12.8	21.8	29.0	7.3	15.4	1.7	3.9	8.0	100
Apr-08	12.3	23.7	35.0	4.9	14.2	1.5	2.5	6.0	100
May-08	12.3	28.3	32.2	3.8	12.8	1.1	3.8	5.7	100
Jun-08	20.3	23.0	32.2	4.1	11.1	0.8	3.7	4.8	100
Jul-08	20.8	22.0	33.7	4.0	10.9	0.9	3.6	4.2	100
Aug-08	**20.5**	**21.2**	**34.3**	**3.2**	**12.1**	**0.9**	**3.9**	**3.8**	**100**

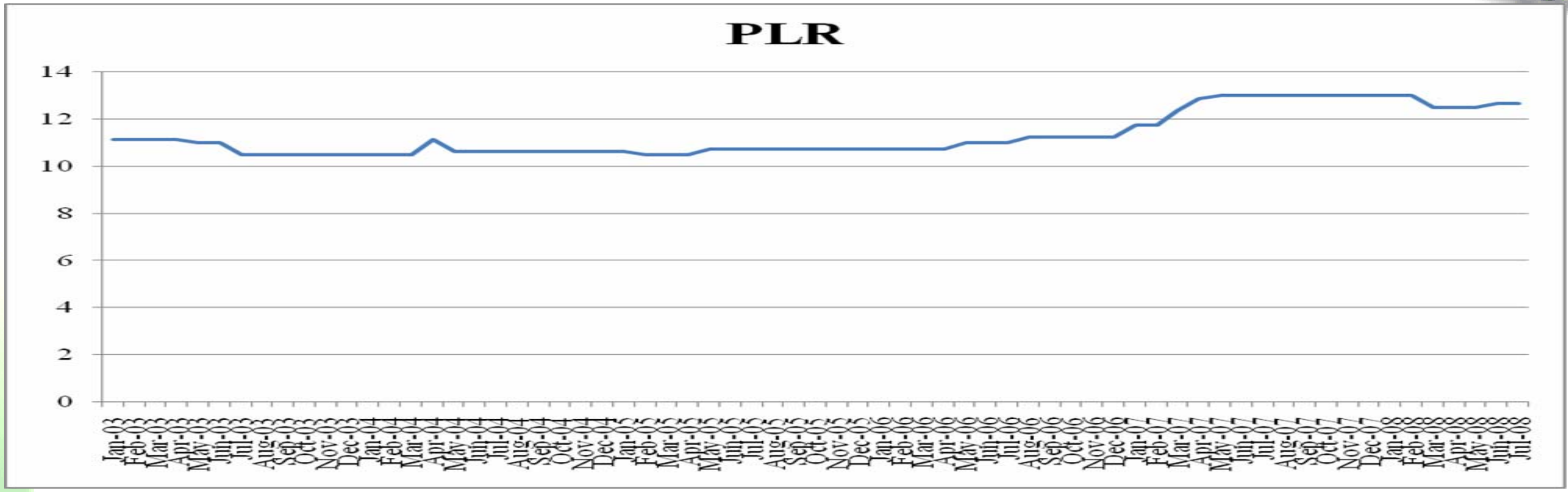
Two thirds from fuel, raw cotton, oil seeds, iron ore, iron & steel and edible oil

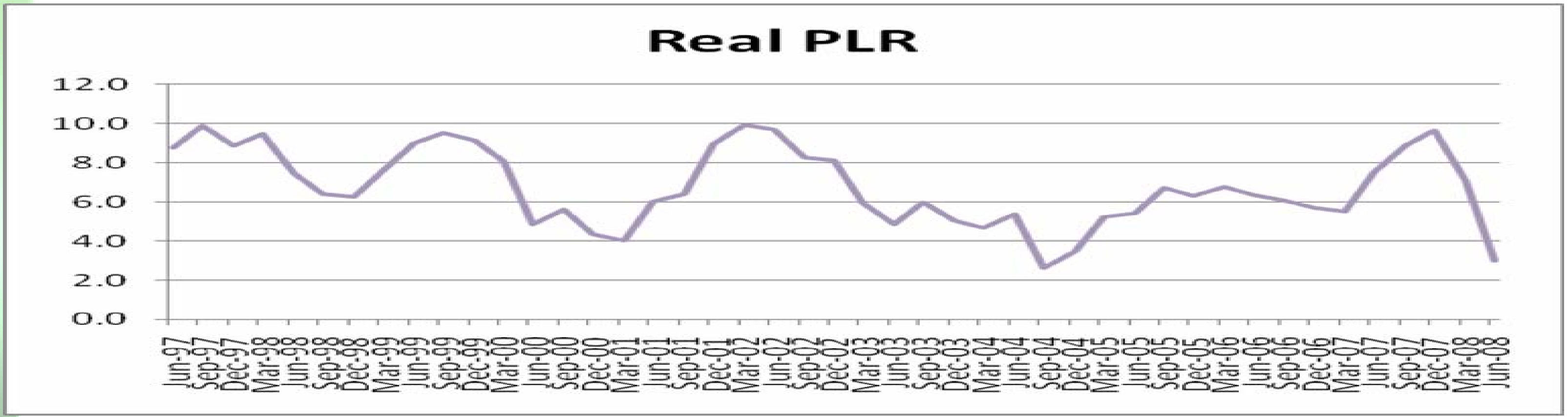
Demand Pressure



Demand pressure remain high despite tight monetary policy

Level of Interest Rates





RBI to raise interest rates to reduce credit growth as real PLR has come down?

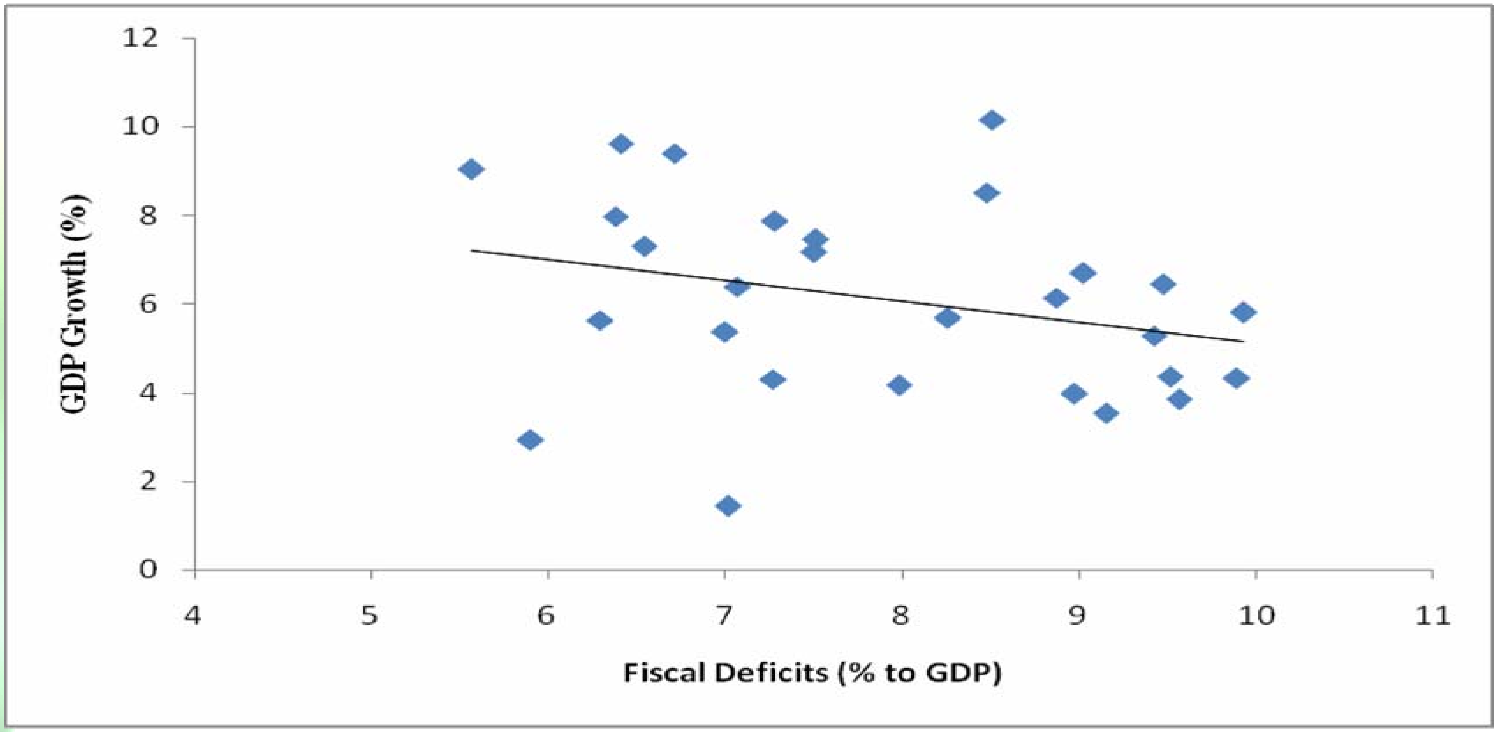
7. Fiscal Situation

Fiscal Deficit

	2007-08	2008-09(E)
	Rs. crore	
Not Provided for in the Budget:		
Salary increase and arrears	-	22100
Farmer loan waiver	11772	17658
Tax reduction for petroleum products	-	22600
Addition to Fiscal Deficit as % of GDP	**-**	**1.1**
Off Budget Items:		
Bonds for Oil Companies	11953	82650
Bonds for Fertilizer Companies	7500	64014
SEB's commercial losses net of state subsidy	11542	13103
Off Budget Items as % of GDP	**0.7**	**2.9**
Fiscal Deficit as in the Budget- Centre	**2.8 (P)**	**2.5 (B.E)**
Fiscal Deficit as in the Budget - States	**2.3 (R.E)**	**2.1 (B.E)**
Total Fiscal Deficit (including off-budget items) % of GDP	**5.8**	**8.6**

- *Centre's fiscal deficit to cross 3% (3.6%) of GDP this year*
- *6.3% if off-budget bonds are added, and 8.6% including states*

Fiscal Deficits and GDP Growth (1981-2 to 2007-8)



- *High fiscal deficit may hurt growth in 2008-09*
- *Conflict with monetary policy*

Thank You