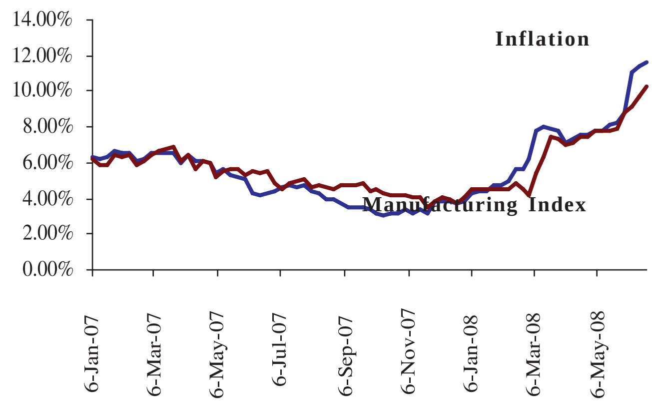
May IIP growth was lower than expected
Headline inflation remains elevated; sizeable revisions add to concerns
4Q GDP at 8.8%

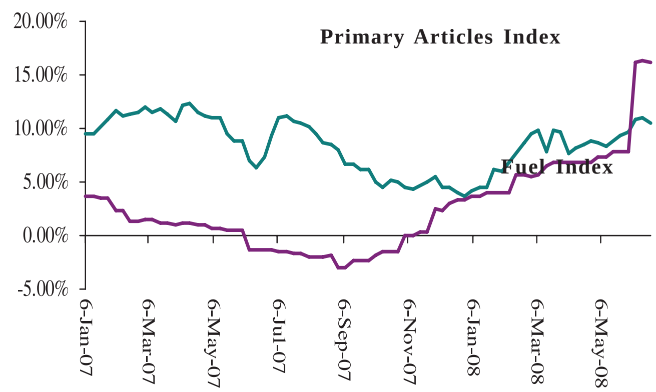


Can India sustain a GDP growth rate of 8.5% with industrial production at 3.8%, headline inflation at 13 year high of 11.89%?

Higher inflation continues to dominate:

The Wholesale Price Index for the week ended June 28, 2008 was recorded at 11.89% (yoy) as compared to previous weeks' figure of 11.63 %(yoy). The food articles (0.5%), Non-food articles (1.8%), Textiles (2.5%) and Chemicals (1.2%), Non-metallic mineral products (0.8%) were the main drivers of the index. Inflation has increased by 9.2% since January 5, 2008 due to rise in international prices of essential commodities including food-grains, processed foods, metals and chemicals. Thus a very large proportion of inflation in India is imported inflation.

In India, the inflation has two main inherent issues. Firstly, it is mix of primary, intermediate and final commodities. Thus impact of rise and fall in prices of commodities is either exaggerated or not correctly reflected Secondly, many commodities in the index have been left unrevised for a long period of time, for eg: those items subsidized by the government. The domestic fuel price hike pushed the fuel index for the week ending June 7, 2008 by 7.78% due to sudden revision of petrol (11.16%), ATF (14%), LPG (20%), Lignite (16.25%), HSD oil (9.8%), LD oil (20.5%) and coke (31%), weighing 7.10, drove the index to 11.05% from 8.75%.



As per the latest press release issued by the Office of the Economic Advisor the prices of only 68 commodities have been revised leading to sudden and large revisions in the index tend to aggravate numbers. Given the current scenario, inflation is expected to touch 15% levels due to persistent high crude oil prices, steel, raw materials and food articles.

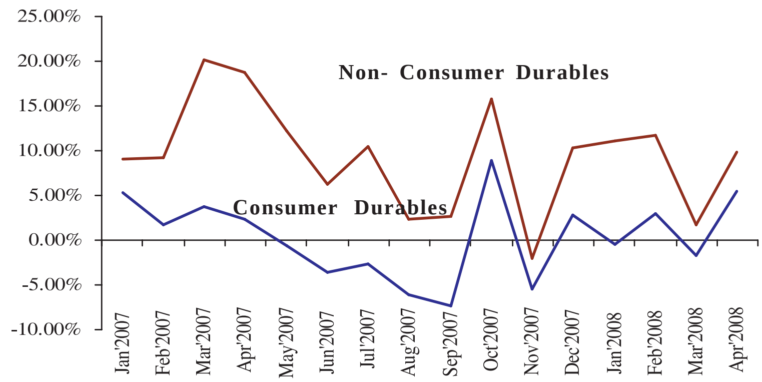
Industrial Performance:

The industrial production for the month of May was reported at 3.8% (yoy). Mining, manufacturing and electricity registered lower growth in the month of May as compared to the same period in the previous year by 5.2%, 3.9% and 2% respectively. The deceleration in the electricity sector by 2% was mainly on account of moderation in thermal power generation and decline in nuclear power generation. High base as well as decline in refinery output in certain public sector refineries contributed to decelerated growth in petroleum refinery products. The slowdown in the cement sector was mainly on account of high base and capacity constraints.

According to use-based classification, the sectoral growth rates in May 2008 over May 2007 saw growth of 3.0% in Basic goods, 2.5% in Capital goods and 1.2% in Intermediate goods. The Consumer durables and Consumer non-durables have recorded growth of 4.4% and 8.1% respectively, with the overall growth in Consumer goods being 7.2% as compared to 12.9% in the month of April.

The impact of hike in repo rate and CRR on the industrial production is evident from the industrial performance. Firstly, consumer demand has declined and secondly, the cost of funds for new and existing projects have become expensive.The high cost of project will extend the payback period further thereby causing uncertainity resulting in deferment of new capacities till the funds get cheaper.

This is evident from CMIE database whereby the projects outstanding at the end of June quarter have declined by 9.99% and addition of new projects have also seen a decline by 10.02%. Further,projects shelved during the quarter have increased by 141.98% implying slowdown in expansionary process in capital investments.



Capital Investments						(Rs. Crore)
		Jun-07	Sep-07	Dec-07	Mar-08	Jun-08
Project investments added during the quarter	Rs.crore	250688	450800	465232	553787	498300
Project investments added during the quarter	%	-8.6	79.83	3.2	19.03	-10.02
Project investments shelved during the quarter	Rs.crore	22529	11871	40629	17896	43305
Project investments shelved during the quarter	%	110.66	-47.31	242.26	-55.95	141.98
Project investments outstanding at the end of the quarter	Rs.crore	4462638	4888418	5411733	6062750	6668471
Project investments outstanding at the end of the quarter	%	4.94	9.54	10.71	12.03	9.99
Source:CMIE						

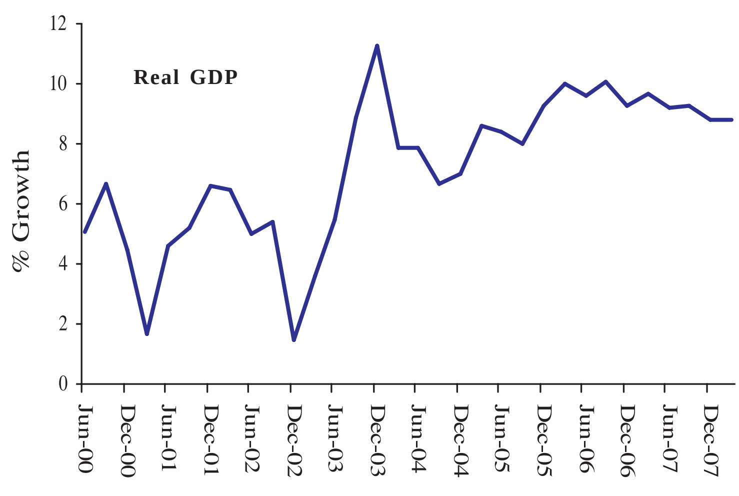
Gross Domestic Product:

There is no country elsewhere across the Asian sub-continent where the monsoons cause as much public concern, political unease and media interest as in India. The reason behind the attention is the fact that monsoons affect the economic growth of this country. India is predominantly agrigarian and contributes approximately 24 per cent to the GDP, provides raw materials for a fifth of the industry and generates demand for industrial goods. Besides, nearly sixty per cent of the population depends on agriculture for their livelihood and forty per cent of the manufactured goods depend on the rural markets. And since only a third of the country is irrigated, Indian agriculture depends heavily on the monsoons.

Quarterly Estimates of GDP - At Current Prices (Rupees in Crore)								
Industry	2006 -07				2007 -08			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Total final consumption expenditure	634,214	633,613	744,669	726,615	707,470	712,123	829,646	836,043
Private final consumption expenditure	524,769	547,834	641,156	598,346	595,537	613,038	719,943	679,067
Government final consumption expenditure	109,446	85,779	103,513	128,269	111,933	99,085	109,703	156,976
Gross capital formation								
Gross fixed capital formation	298,053	314,446	347,290	386,712	357,045	385,921	411,002	444,110
Changes in stocks	21,908	23,146	34,428	26,622	25,625	26,404	27,778	29,513
Valuables	13,015	13,331	14,015	9,347	14,073	15,676	18,806	10,656
Error and Omissions								
Exports	206,273	228,930	215,183	265,289	223,634	227,638	254,885	298,908
Less Imports	245,903	266,763	263,627	264,504	268,153	275,535	309,756	298,295
Discrepancies	-11,084	11,010	31,198	8,386	2,351	-12,293	19,785	-1,913
GDP at market prices	916,476	957,712	1,113,155	1,158,468	1,062,045	1,079,935	1,252,147	1,319,021
Source: CSO								

The 4Q GDP rose by 8.8% as compared to 9% over the previous quarter. The sectors which showed growth rates of 5 per cent or more, are 'manufacturing' (9.3 %), 'electricity, gas and water supply' (5.3%), 'construction' (8.4%), 'trade, hotels, transport and communication' (11.3%), 'financing, insurance, real estate and business services' (11.6 %), and 'community, social and personal services' (7.6 %).

However, private final consumption expenditure has declined by 5.68% over the third quarter.Gross fixed capital formation has moderated over the 4th quarter to 14% as compared to the same period in the previous year. The rise of repo rate to 8.5% and CRR to 8.75% will not only stall consumption demand but also investment demand.Hence the 2nd quarter may see a further moderation in growth to 7.5%.



Related Developments:

Widening Trade Deficit

Trade deficit increased to USD 23.8 bn in Q4 of 2007 - 08 against USD 12.9 bn Q4 of 2006- 07. The rise in import bill and moderating exports resulted in further widening of the trade gap. The breakup of imports shows a sharp rise in oil imports and decline in non-oil imports.

Balance of Payments

All figures in USD mn			2006 - 07	2007 - 08			
	FY07	FY08	Q4	Q1	Q2	Q3	Q4
Exports	128,083	158,461	35,700	35,752	37,595	42,284	42,830
Imports	191,254	248,521	48,570	56,453	58,069	67,376	66,623
Trade balance	(63,171)	(90,060)	(12,870)	(20,701)	(20,474)	(25,092)	(23,793)
Invisible receipts	115,074	145,257	35,715	29,100	32,322	38,764	45,071
Invis ible payments	61,669	72,600	18,593	14,700	16,792	18 ,789	22,319
Invisibles net	53,405	72,657	17,122	14,400	15,530	19,975	22,752
Current account balance	(9,766)	(17,403)	4,252	(6,301)	(4,944)	(5,117)	(1,041)
Capital account	45,779	1 08,031	15,640	17,346	33,960	31,300	25,425
of which:							
FDI	8,479	15,545	899	2,658	2,808	3,729	6,350
Portfolio investments	7,062	29,261	1,849	7,458	10,876	14,662	(3,735)
ECB	16,155	22,165	6,343	6,990	4,136	6,212	4,827
Sh ort - term trade credit	6,612	17,683	934	1,804	4,886	4,691	6,302
External assistance	1,767	2,114	764	241	468	565	840
NRI deposits	4,321	179	648	(447)	369	(853)	1,110
Errors and Ommissions	593	1,536	560	155	220	555	606
Accretion to reserves	36,606	92,164	20,452	11,200	29,236	26,738	24,990
Source: R BI							

The main features of FY08 data for India's Balance of Payments (BoP) are listed as under:

(i) sharp rise in trade deficit was led by sharp rise in oil imports by 34.6%, driven mainly by the surge in international crude prices while imports in terms of quantity showed subdued growth.

(ii) steady increase in invisible surplus by 26.2% in Q4 of 2007-08 as compared to 25.6% in Q4 of 2006-07 is led by remittances from overseas Indians and software services;

(iii) current account deficit rose by at 1.5% of GDP in FY08 against 1.1% in FY07;

(iv) significant increase in the capital inflows was led by FDI,though FDI has been bi-directional A major part of outflows from NRI deposits is in the form of local withdrawals. These withdrawals, however, are not actually repatriated but are utilised domestically.

(v) accretion to reserves is reflected in investment income as receipts rose by 54.9% during 2007-08 as against 43.0% in 2006-07.

External sector outlook

Given the fact that commodity prices are at all time highs and are expected to remain high for several import items in the international market, particularly oil, merchandise trade deficit will remain under pressure in FY09. The gradual decline in capital flows have caused steady fall in the accretion of reserves.Therefore, the governmnet has increased FII limit in domestic bond market and relaxed borrowing scheme under ECB route.

Fiscal deficit

Government finances data for May reflects that the key deficit indicators, viz., revenue deficit (RD) and gross fiscal deficit (GFD) were higher than the corresponding period of the previous year. RD and GFD for May 2008 stood at 122.7% and 54.9%, respectively, of the FY09 Budget estimates (BE).

The central government projected the fiscal deficit for FY09 at 2.5% of GDP mandated by the Fiscal Responsibility and Budget Management (FRBM) Act. However, going forward the estimates may be revised to 3-3.5% after taking into account possible loss of revenue due to lower tax buoyancy, loss of tax revenue following exemption of excise and customs duty on several commodities, additional expenses following agricultural debt waiver scheme, and the Sixth Pay Commission recommendations, possible surge in pre-election spending etc., and off-balance sheet items like food, fertilizer and oil bonds.

Government Securities	Institutional Sales	Fixed Income Research	Debt Fund Management	Settlements	Delhi Office
Prasanna Patankar	Siddharth Shah	Jyoti Gupta	Sabita Braganza	M N Suresh	K K Mittal
Manish Jadhwani	Subodh Kapadekar	**Mutual Fund**	Geetha	Anita P Mohite	**Bangalore Office**
Rahul Sangle	Suresh Gonsalves	Tejal Joshi	Meghna Patel	Smita Nair	N V Subramani
	Rakesh Ojha	Abhishek Bandiwdekar		Shyam Margaj	
	Shivangani Singh				

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