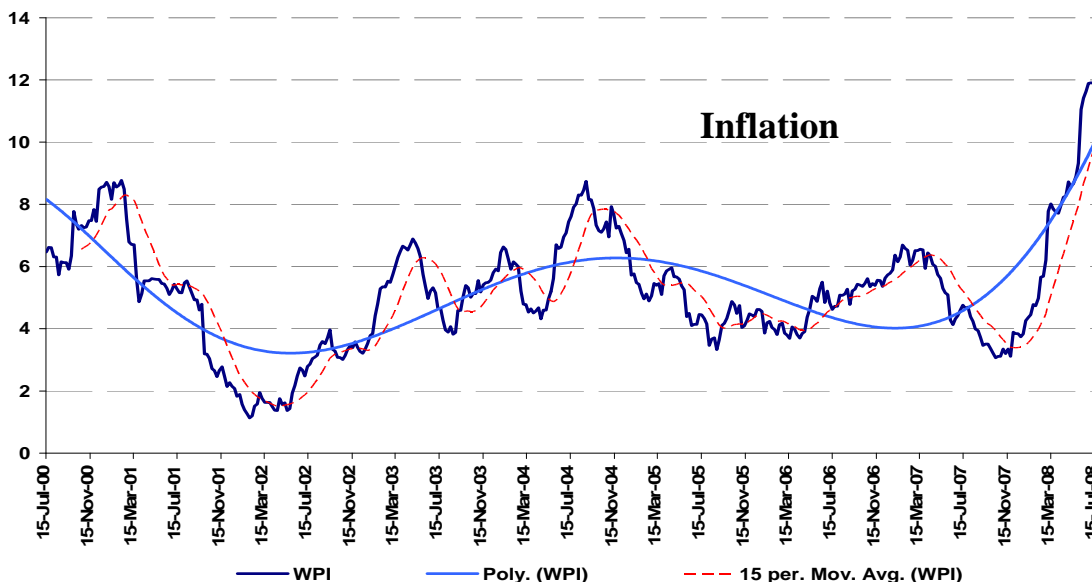


The advanced economies are presently reeling under slowing demand and rising inflation. Economic growth has slowed down globally in response to the confluence of declining consumer and investor confidence, monetary tightening and capital market uncertainty. According to IMF Economic Outlook July 2008, global growth is projected to decelerate from 5% in 2007 to 4.1% in 2008 and 3.9% in 2009.

Since India is now an integral part of the global economy, it cannot remain insulated from the current international environment. India is currently experiencing rising inflation due to runaway increase in the prices of crude, petroleum and steel. This has pushed up the prices of a wide range of commodities including chemicals, fertilisers, synthetic fibres and machinery apparent in the whole sale price index, a most closely watched cost of living monitor. The domestic credit and equity markets have been adversely affected due to deteriorating asset markets. Industrial production data for the coming months reflects sluggishness in the industry. The Current Account Deficit (CAD) is likely to widen due to rising oil-import bill and subsidies may continue to pressurise the fiscal system.

Higher inflation continues to dominate:

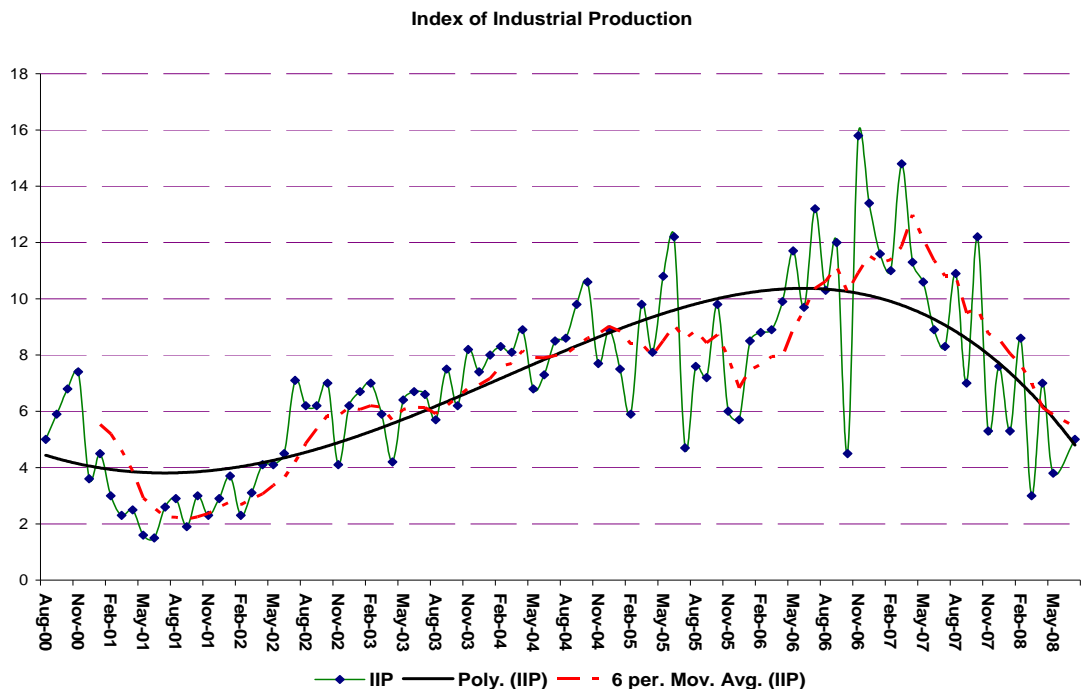
The Wholesale Price Index for the week ended August 2, 2008 was recorded at 12.44% (yoy) as compared to previous weeks’ figure of 12.01 % (yoy). Food articles (up 0.9%), light diesel oil (up 16%), bitumen and furnace oil (up 8%) each and aviation turbine fuel (up 3%) are the main drivers of the index. Inflation index climbed by 17 bps (0.71%) over the last month driven primarily by Pulses (4.9%), Fruits (9%), Other Non-food articles (1.7%), Textiles (1.3%) and Mineral oils (1.8%).



Response in terms of demand for steel and crude has weakened globally amidst economic slowdown. However, the demand from the emerging markets like China, as it hosts Olympics 2008-09, has been comparatively strong. Moreover, the shift in generic consumption pattern for edible oils in producing bio-fuels will continue to pressurise its prices. On the flip side, the record food-grain production of 230.7 million tonnes in the year 2007-08 and better than expected South-West monsoon is likely to augur softened prices for food items. Going forward inflation till December 2008 is likely to be elevated at double-digit levels taking signals from the highly volatile commodities market.

Industrial Performance:

The Industrial Output released for the month of June posted a modest 5.4% (yoy) growth compared to 8.9 % over the previous year. It showed a partial recovery in manufacturing output, which accounts for nearly 4/5 of the total weight of the Index. Manufacturing output rose 5.9% in June as compared to 4.2 % in May, albeit the estimates were way below the 9.7% growth recorded a year ago. The electricity sector showed signs of improvement, growing at 2.6% during June against the 1.2% in the previous month. The estimates were lower than the 6.8% growth recorded in electricity generation recorded a year ago. The mining sector grew by 2.9% in June, significantly lower than the growth estimate of 5.1% in May but higher than the 1.5% recorded in June 2007. Use-based classification of the IIP shows that the consumer durables sector gathered momentum in June, registering a growth of 3.5% against a -3.6 % estimated last year, pushing up the overall consumer sector growth to 10%.



According to the “Monetary and Macro-economic developments July 2008-09”, money supply (M3) and bank credit were seen at 21% and 25.8% way above RBI’s comfort level of 17% and 20%, respectively. Monetary expansion reflects strong pace of economic activity arising from strong demand for funds. Steady growth in credit by 26% reflects bank lending to the corporate sector has not tapered off. During the current financial year RBI has repeatedly intervened to rein in excess liquidity, increasing the Cash Reserve Ratio (CRR) by a total of 150 basis points to 9.0 per cent, and the repo rate by 100 basis points to 9.0 per cent. The sharpest increase in bank lending was observed in industry and infrastructure. Bank lending to the Small Scale Industry (SSI) and infrastructure increased by 52% and 42%, respectively. However, Lending to the real estate sector saw a decline. Having said this, another round of monetary action could be round the corner if the monetary parameters fail to simmer down in due course of time.

Related Developments:

Widening Trade Deficit

India’s exports for the month of June, 2008 were valued at Rs.62790 crore higher as compared to 29.7% during June, 2007. Cumulative value of exports for the period April- June, 2008 was Rs.178480 crore as against Rs.144358 crore in the corresponding period of the previous year. At the same time India’s imports during June, 2008 were valued at Rs. 104705 cr recording a growth of 32.2% over the level of imports valued at Rs.79200 cr in June, 2007. Cumulative value of imports for the period April- June, 2008 was Rs.305265 crore as against Rs.232855 crore registering a growth of 31.1% over the same period last year. %. The value of oil imports was reported 50.2 per cent higher and non-oil imports 20.9 per cent. The trade deficit for April- June, 2008 was estimated at Rs. 126785 crore which was higher than the deficit at Rs.88497 crore during April- June, 2007.

EXPORTS & IMPORTS : (Rs. Crore)				
(PROVISIONAL)	2007-08		2008-09	
	June	April-June	June	April-June
EXPORTS(including re-exports)	48400	144358	62790	178480
%Growth 2008-09/2007-2008		29.7		23.6
IMPORTS	79200	232855	104705	305265
%Growth 2008-09/2007-2008		32.2		31.1
TRADE BALANCE	-30800	-88497	-41915	-126785
Figures for 2007-08 are the latest revised whereas figures for 2008-09 are provisional				

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 government has increased FII limit in domestic bond market and relaxed borrowing scheme under ECB route.

Fiscal deficit

The improvement in the fiscal situation is mainly attributable to a significant increase in buoyant tax collection, particularly personal and corporate income taxes and service tax have thus helped improve the fiscal performance of the Central government. The gross fiscal deficit as a percent of GDP declined steadily from 6.2% in 2001-02 to 3.1% in 2007-08. Revenue deficit fell from 4.4% of GDP in 2001-02 to 1.35% percent in 2007-08 and is budgeted at 1.04% in 2008-09. 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 4-5% after taking into account off-budget liabilities on account of fertiliser, food and oil, along with unbudgeted liabilities arising out of the farm loan waiver and NREGA schemes and the implementation of the Sixth central Pay Commission.

	Actuals Upto June 2008	Actuals Upto June 2007	Actuals Upto March 2007	Actuals Upto December 2007	Actuals Upto September 2007
Revenue Receipts	82315	64428	539894	355646	197956
% growth	27.76%		52%	80%	
Tax Revenue (Net)	74735	57470	437517	295994	160500
% growth	30.04%		48%	84%	
Corporation Tax	35531	24782	189541	128698	70176
Income Tax	20007	13340	105699	66268	35446
Customs Duties	28031	23376	102881	74455	48098
Excise duties	16779	16934	123315	75485	44889
Service Tax	9835	0	0	0	0
Other taxes	3449	10063	69681	44439	24882
Surcharge for financing NCCF	-442	-418	-1800	-1694	-1140
States	-38455	-30607	-151800	-91657	-61851
Non-Tax Revenue	7580	6958	102377	59652	37456
Non-Debt Capital Receipts	498	3068	43893	41029	38736
Total Receipts (1+4)	82813	67496	583787	396675	236692
Non-Plan Expenditure	106776	131999	508043	337090	231134
Plan Expenditure	62163	47901	205558	137163	86758
Total Expenditure (8+11)	168939	179900	713601	474253	317892
Fiscal Deficit (14-7)	86126	112404	129814	77578	81200
Revenue Deficit (9+12-1)	76557	68646	55535	39210	61124
Primary Deficit {15-9(i)}	50214	78130	-41680	-34186	8380

***The increase in Fiscal deficit in June 2007 is due to increased capital expenditure incurred on 'Acquisition cost of RBI stake in SBI (Rs.35, 531 crores). This expenditure will be neutralized by realizing equal amount of receipts from RBI during the course of this financial year. After excluding this transaction, the fiscal deficit up to June is Rs. 76,873 crores.

In 2007-08, the revised estimate of fertilizer subsidy is Rs.30, 501 crore (**Source: Economic Outlook 2008-09**) and an additional Rs.7, 500 crore is provided by way of bonds to fertilizer companies. For 2008-09, the subsidy is budgeted at Rs.30, 985 crore. Given the increase in feedstock prices and the price of imported fertilizers, total fertilizer subsidy for 2008-09 is likely to be more than Rs.95000 crore. This alone amounts to 1.2 per cent of GDP. The reassessment of the fertilizer subsidies for the year 2008-09 has been valued at 1.19 lakh crores. Against this the government has decided to release cash for an aggregate amount of Rs. 22,000 crores and another Rs. 31,000 crores in three months. This will push up the subsidy amount to Rs. 84,000 crores in addition to the budgetary amount of Rs. 31,000 crores for 2008-09.

The under-recoveries in oil bonds for the first quarter 2008-09 has been estimated at Rs 48,000 crore of which the Petroleum Ministry has decided to issue oil bonds worth Rs. 24,000 cr (50%) to the oil marketing companies (OMCs) to partly offset their under-recoveries.

Bonds issued under the market stabilisation scheme carry a very high interest rate. In 2008-09 the expenditure on this account is estimated at Rs. 13958 crore (**Source: Economic Outlook 2008-09**). In 2008-09, the outgo on account interest paid on the bonds issued to oil and fertilizer companies and the Food Corporation of India is estimated at Rs. 8000 crore. The Oil Bond burden of the central government in 2008-09 could be a little over 2 per cent of the GDP (**Source: Economic Outlook 2008-09**).

The government initiated the implementation of pay hike under the Sixth pay commission. The cabinet commissioned average increase of 21% of the salaries with retrospective effect from January 1, 2006. The hike comes into effect from September 2008 and the arrears from January 2006 would be disbursed in instalments of 40% in the current fiscal and the remaining 60% be borne in the 2009-2010. The financial implication of the hike will be to the extent of Rs. 15,700 crores on the Central budget and additional Rs.6, 400 crores on Railway budget in 2008-09. The pay hike and arrears on one hand will add to the aggregate domestic demand and on the other hand increase average tax collection by Rs.3, 700 crore annually via personal tax collection and provident fund.

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