

Monthly Economic Analysis

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Macro Economic Developments

Industry

In January 2005 industrial production achieved a growth rate of 8.3%, higher than that of the corresponding period of previous year, aided by manufacturing, which continues to be the growth driver of the industry, registering a growth of 9.2%.

Growth in the Consumer goods slackened in the month due to slippage in the consumer non-durables sector, consumer durables however, grew at a faster pace in January 2006 than the corresponding month of the last fiscal. The capital goods segment posted a growth rate of 26%, highest in the last 10 months, while production of intermediate and basic goods also firmed up.

As many as six of the 16 major industry segments recorded double digit growth in April- January 2005-06, which are Textile products, Beverages and Tobacco, Basic Metals, Transport equipments, Machinery and Equipments and Non metallic minerals.

Core Infrastructure Industries

There was a slowdown in the overall infrastructure growth during April – January 2005-06. Cement continued to grow steadily, registering a 15.4% growth rate in January 2006. Among the other core infrastructure industries Petroleum, Coal and Power production grew faster as compared to last year while production of Finished Steel dipped for the first time in the last 10 months.

Telecommunication

An addition of 36 million phones to the country's telephone network was made during April to February 2005-06, which surpassed all records made in the past months. In a period of eleven months ending February 2006, the total number of phones stood at 134.3 million with teledensity reaching 12.28%, largely on account of new mobile phone connections to the order of 32 million. In February 2006 alone a net addition of 4.27 million was made to the total mobile network.

Stock Market Trends

Sensex surpassed 10,000 points for the first time to hit a new peak at 10566 points. Nifty too went up to 3123 points. This surge was on the back of FII investments in the secondary market.

Monetary Indicators

During the period of April to February of the current fiscal, money supply expanded faster as compared to its growth during the corresponding period previous year. Bulk of the growth was on account of increase in bank credit to the commercial sector, which was higher than the last year. Minimal contribution was from the government borrowings and Foreign exchange assets. A substantial jump in the aggregate deposits and significant increase in credit off take by the non-food segment were seen during the period.

Fiscal Trends

Gross tax collections by the central government increased at 20.7% in January 2006, a rate marginally higher than the previous year. Collections from the corporation tax was the highest though it grew at a slower pace; Highest rise in collections was from income tax which witnessed a 24.5% rate of growth.

Cumulative plan spending up to January 2005-06 on the revenue side rose substantially at 38% up from 3.9% last year and was much more than the projected value, however capital spending declined by 32% as compared to the 8.1% rise last year.

Inflation

The WPI indicated a slowdown in prices since June 2005, as compared to the corresponding months of the previous fiscal. In February, prices went up by 4.2% as against 4.9% in the previous year. Prices have firmed up for Primary food articles whereas slowed down for Fuel, power and lubricants and Manufactured products. While Food articles became expensive, prices for non-food articles fell further.

In the Manufacturing segment price escalated for Food Products, Wood, Rubber and Non-metallic products whereas prices for Beverages, Paperboard, Leather products, Chemicals, Basic metals, Machinery, transport equipment became grew slowly, and only Textile became cheaper. Among the 45 manufactured products, prices increased faster for 14 products, slowed for another 17 items and dipped for remaining 13 items in February 2006 against corresponding month of previous financial year.

Merchandise Trade

During April- February 2005-06 exports picked up by 26 %, marginally higher than the growth in the corresponding period last year. In February alone exports were higher by 12% against 8% last year.

Imports during the period of April to February 2005-06 grew at a marginally lower rate of 33% against 34.7% last year. In February oil imports grew at 72%, lower

than 86% in the corresponding month of last year while non-oil imports saw a much faster growth at 100%, over a 39% increase in February 2005.

Detailed numbers available up to November show that the rate of growth of total exports and imports were slower in the April-November 2005-06 against corresponding period of previous year. Exports of Broad Commodity decelerated during the period in all the segments compared to corresponding period of previous FY except for Handicrafts, which saw a 5.8% growth in exports.

Capital Inflow

Total Foreign investments stood at \$ 10140 million during April to November 2005-06, much higher than the last Financial Year. The increase in FDI during April-November 2005-06 was contributed mostly by Portfolio investments. November 2005 figures show portfolio investments mainly on account of inflow through ADR and GDR route.

During April – November period 2005-06, NRI deposits with commercial banks also increased to \$ 248 million as against a fall in the corresponding period of the last fiscal year.

Foreign Exchange Reserves

Foreign exchange reserves regained from \$139 billion a month ago to \$ 143 billion in February 2006 on account of substantial additions in foreign currency assets and marginally in gold reserves.

Exchange Rates

Most recent trends show Rupee vis-à-vis USD hovering at Rs 43-44 in the first two quarters of 2005-06, which weakened in the third quarter and in the current quarter again appreciating above Rs 45. The fluctuation of the Rupee vis-à-vis Euro was slightly more than its movement against USD. In February 2006 negligible appreciation was witnessed in Rupee vis-à-vis USD with the value remaining almost same as in previous month whereas, INR hardened against Euro, appreciating by 1.5%.

Lead Stories of the Month

Economic Survey, Union, Rail Budgets

The Economic Survey, the Union Budget and the Railway Budget, all presented to parliament in February, have set the tone for economic management during the current year. The general budget discussions, which continued till the middle

of March, have further crystallized the series of policy measures the government proposes to implement in the next few months.

Of the three major pronouncements, the Economic Survey reviews the state of the economy and prescribes the measures needed to further push up growth. Taking its cue from the Economic Survey, the budget has suggested a crop of new schemes and initiatives. The railway budget, on the hand, set forth the imperatives of operation of a major sector of the Indian economy. The general approach of the railway budget this year has been one of regenerating the railway system to tackle the higher demands on it from faster growth. We will examine these three pronouncements separately.

Economic Survey 2005-06

The Economic Survey for 2005-06 has called for de-bottlenecking the infrastructure sector and hastening the pace of tax reforms for achieving faster growth. These are envisaged to give the Indian economy and industry a shot in the arm.

The Survey suggests a broad range of tax reforms for unburdening the Indian Industry from the distortive effects of existing tax structure for making Indian Industry more competitive in a globalised world. Indian industry has been advocating that the tax rates in India should be brought down to the ASEAN levels and that incentives should be provided for infrastructure development, R&D and investments, as is the practice worldwide.

It observes that both savings and investments have to be raised and a virtuous cycle of higher savings and investments will push up the growth rate of the Indian economy. The survey refers to the demographic dynamics and forecast a rise in household savings rate. This is expected to push up overall investment rate in the economy.

The Survey stresses on infrastructure creation. Lack of adequate and quality infrastructure has proved to be one of the main constraints on Indian Industry to achieve a faster rate of growth and achieve global competitiveness. It points out that power shortage is the single most important impediment to the growth. Estimating a 12% peak power shortage in the current fiscal, the Survey has portrayed a gloomy picture of the consequences, saying, it could mean a whopping loss of Rs 300,000 crore to the economy.

The Survey suggests a few quick remedies – faster reforms, adequate fuel supply and suitable policy packages. The Survey projects a dismal picture of states' power sector financial performance, as resources forgone through high losses and poor returns continue to be very large. Such a situation demands a more vigorous push towards private sector power generation, it has been pointed out.

In this context, the Survey underlines the need to liberalize the FDI regime for captive mining, especially in coal, which accounted for 60% of the country's primary energy requirements and 70% of the power generation. In addition, other segments of infrastructure sector call for investments of Rs 1.72 lakh crore for highways alone by 2010 and Rs 40,000 crore for airports and Rs 50,000 crore for ports by 2012.

The Survey urges fiscal correction both at the center and the state levels. In this context, it cautions the government before constituting 6th Pay Commission to avoid further deterioration of state and central finances.

Union Budget

The Union Budget for 2006-07 has sought to lay down a blueprint for the country to achieve 10% growth in the next two to three years. The emphasis of the budget is on growth and investment and this strategy is reflected in higher allocation for critical sectors, which should push up the growth rate in the near future.

A major positive feature of this year's budget is the clear signal given by the Finance minister on introduction of a comprehensive Goods and Services Tax (GST) by 2010. This should serve to integrate the economy and make India a single common market. While congratulating the finance minister on this announcements, industry and business sources hoped that the timeline on implementation of GST would be adhered to.

In achieving the goal of higher growth, the finance minister has focused attention on, first, creation of physical infrastructure in the form of roads, ports, airports and adding to power generation capacity. Secondly, the Finance minister has stressed on building up social infrastructure by way of education, healthcare, water supply and rural empowerment. These should help the Indian economy to increase and sustain a higher level of growth rate.

The finance minister's decision not to undertake drastic changes in the tax structure and introduce new taxes in this budget has been widely welcomed. Many coalition partners of the UPA government had demanded introduction of new taxes. The finance minister, however, maintained that over the course of the last two budgets, he has put in place a long-term fiscal and taxation structure which need not be tampered with every year.

To give relief to people and create additional demand, the finance minister has lowered excise duty on a wide range of items, which will make Indian manufacturing industry competitive. The finance minister did not, however, comply with the demands of industry and businesses to scrap the widely debated

fringe benefits tax (FBT). He made efforts to simplify the FBT while retaining the basic tax.

On the tax front, several reforms have been initiated both in direct and indirect taxes to make these more friendly. The increase in the threshold of Rs 1 lakh towards superannuation fund is a step in the right direction.

The reduction in the peak customs duty from 15% to 12.5% is a step that would align Indian tax rates with those of ASEAN countries. Industry has urged the government that reduction in peak customs tariff should be calibrated with internal reforms.

In his move towards GST, the Finance minister has proposed to increase the Service tax rate from 10% to 12%. However, he has not reduced the CENVAT from 16% to 14%.

Further opening up the Indian capital markets, the Finance minister revised the FII investment limits in corporate debt and government securities upwards. Further, allowing Indian investors greater exposure in markets abroad would further integrate India with the international economy.

Railway Budget

The Railway Budget for 2006-07 proposes a slew of “innovative and pragmatic” measures for overall regeneration of the Indian railways through modernization and technological upgradation.

With the operating ratio expected to be 84.3% in 2006-07 from 90.8% in 2005-06, the financial health of the Indian railways is expected to improve substantially. This improvement in the operations has enabled the railway minister to pass on some marginal reduction in passenger fares in air-conditioned classes, thereby making the railways more competitive vis-à-vis the budget airlines.

The rail budget has been described as “innovative” by industry circles as it seeks to lower the turnaround time of wagons through several measures. Additionally, it proposes to add more coaches to existing and new trains to increase haulage capacity without any major investments. The railway minister has also sought to increase the overall capacity through balancing investment. These will result in adding incremental capacity to the railway network at various operating levels.

The minister has adopted a very pragmatic freight policy by lowering the number of classes of commodities, introduction of non-peak traffic discounts and other such facilities. These would, undoubtedly, help the railways to attract more freight traffic.

Another welcome feature of the budget is the announcement of dedicated high axle freight corridors. Train movements on these corridors would have computerized freight movement tracking systems. On completion, these projects should be able to metamorphose the Indian railway system.

The minister has talked of technology transfer for high capacity wagons, wider application of IT, provision for new improved signaling and introduction of 25-tonne axle load wagons. He has also proposed increasing the production of electric locos by 17% and diesel locos by 5%. In view of the high oil prices, introduction of electric locos would result in cost saving and increase in haulage capacity.

FDI into India Surges

Foreign Direct Investment (FDI) inflow into the country has registered an increase of 326% in January 2006 amounting to \$647.7 million against \$152 million in January 2005 last. According to Minister for Commerce and Industry Kamal Nath "What is heartening about the growth in FDI is that the inflows are coming in the manufacturing sector, which we want, and will contribute increased share in India's GDP." The Minister indicated that FDI inflow in equity during the first nine months stood at \$4.34 billion. This represents an increase of 60.5% over the FDI inflows of \$2.7 billion received during the corresponding period of the previous year 2004-05. The major investing countries during this period have been Germany (35%), the UK (26%), Mauritius (22%), Singapore (6%) and the US (2%).

Meanwhile, according to a survey by credit rating agency, S&P, India witnessed a 13.2% increase in FDI last year to \$6 billion and has been the highest beneficiary among the five largest Asian FDI beneficiaries. As per a report released by Standard and Poor's (S&P), Asia continued to receive the highest FDI inflows in 2005, as it has for the last six years. It accounted for 44.7% of the total FDI inflows amounting to \$161.5 billion. S&P believes that the Asian high yield corporate sector would witness another strong year in 2006, as defaults stay low and economic conditions remain relatively strong. However, it expects the credit volatility to gradually emerge over the medium term as interest rates rise and the quality of issuances deteriorates. Further, global FDI inflows increased by 29% in 2005 to \$896.7 billion from \$695 billion in 2004. This sharp increase resulted from a 37.9% rise in inflows to developed countries.

India third in commercial consumption spend

The commercial consumption expenditure for the Asia-Pacific region is expected to exceed \$16 trillion in 2006, according to a Visa Asia Pacific global Commercial Consumption Expenditure (CCE) study. India comes third in terms of CCE spend after Japan and China. Asia Pacific is the third-largest spending region among

the CCE index's six regions, behind the US' projected total of \$17.4 trillion, and Europe's predicted 2006 commercial spending level of \$22.1 trillion.

Within the Asia-Pacific region, Japan continued to report the biggest CCE spend (\$5.4 trillion) followed by China (\$3.6 trillion) and India (\$1.9 trillion). China represented the highest rate of year-on-year growth at 16%, with India reporting 13%.

According to Michael Cannon, GM, Commercial Solutions, Visa Asia Pacific, these figures further underpin the phenomenal speed at which the Asia Pacific economy is growing. In just a year, Asia-Pacific has moved from the fifth-ranked region for the rate of expenditure growth worldwide to the second highest, mainly fuelled by growth in China. This percentage growth rate is expected to continue, bringing the region's total CCE closer to that of Europe.

India invites bids for 55 oil, gas, coal blocks

In a bid to give a boost to its efforts to scout for oil and gas in the country, India has launched its most ambitious bidding round ever, inviting tenders for 55 oil and gas blocks and 10 coal bed methane (CBM) blocks.

The 55 blocks - 24 in deep sea, 6 in shallow offshore and 25 onland - on offer under the sixth round of New Exploration Licensing Policy, account for half the number of blocks awarded in the previous five auctions.

After five rounds, the area under exploration has increased more than three times and reserve accretion has already been around 600 million tonnes and US \$5-billion of investment commitment received, according to petroleum minister Murli Deora. The evaluation criteria for the latest round has undergone major change to discourage speculative bidding. More emphasis has been laid on the technical capability of the operator and the revenues it is willing to share with the Government.

The previous rounds laid more emphasis on work programme - the commitment by the bidder to do seismic survey and drill well - which led to highly exaggerated bidding.

The National Exploration and Licensing Policy (NELP) has seen major discoveries by Reliance, ONGC and GSPC off the east coast. Reliance has also discovered 3.7 trillion cubic feet of gas below the coal seams in the CBM blocks offered to it in the earlier rounds while ONGC has established 1.4 tcf of CBM reserves.

Since 2000, on an average four discoveries of oil and gas has been reported. last year 15 finds were reported, according to V K Sibbal, Director General, Directorate General of Hydrocarbon.

Indian oil PSUs buy stake in African block

Indian Oil Corporation-Oil India Ltd combine will shortly sign an agreement to acquire stake in an oil and gas block in Gabon, Africa. According to the sources, Oil India and Indian Oil will soon sign an agreement to buy 90% participating interest in a block in Gabon. Both Indian Oil and Oil India will have 45% stake each in the block. The consortium will invest \$12.5 million to buy the stake and will spend another \$50 million on its development. Oil India will be operator of the block.

M&A deals expected to cross \$25 billion in 2006

Mergers and Acquisitions (M&A) have acquired centrestage at the start of this year with expectations of US \$25 billion worth of M&A activity during 2006. In the first two months of the current calendar year itself, 57 deals worth US\$ 3.5 billion have materialized , notable among them being ONGC Videsh-Brazilian Oil field(\$1.4 billion), Dr Reddy's-Betapharm (\$571.7 billion), and Jet Airways-Air Sahara(\$500 million).

The year 2005 was also a good year for M&A. The year saw a total deal value of \$ 18.2 billion, of which, \$16.2 billion was acquisitions and \$ 2 billion private equity investments.

The 2006 Budget duty cuts has brightened the outlook, according to corporate advisory firm Grant Thornton. Cross border deals accounted for 78% of the total M&A deal value during January and February 2006. Outbound deals (Indian companies acquiring business abroad) were valued at over \$2.2 billion and comprised 63% of the M&A deal value. United Phosphorous' acquisition of Advanta Netherlands for \$119 million was another major cross border deal.

With increased economic activity, people are seeing the value they can have from exits. The loyalty of key employees is reducing. The promoters' attachment to their business venture is coming down and they exit on being offered a better value proposition. Total M&A deal value may jump 44% to \$25 billion in 2006.

Private equity investment also witnessed hectic activity. There were 32 private equity deals valued at over \$400 million in January and February 2006, mainly in IT-ITeS and banking sectors. The last few years have also seen a shift from pure venture capital early stage funding to private equity funding based on track record. In many cases even private investment in public equity is being witnessed. For instance, Fidelity's acquired 9% stake worth \$49 million in Multi Commodity Exchange of India last month. This was the first foreign investment in an Indian commodity exchange.

Other major PE deals in last two months were Farallon's buyout of 33% in Indiabulls Housing Finance worth \$25 million and SAIF's (SoftBank Asia Infrastructure) \$ 23 million investment in Cybernet Software.

The Budget 2006 is also expected to have a positive impact on M&A activity, as per the survey. The Budget proposed five ultra mega power projects of 4,000 MW each by Dec 31, 2006, alongside outlaying Rs 97 crore for non-conventional energy resources. The survey predicts increase in interest in travel related services.

Indo-US trade to double in 3 yrs

India and US are working on ways to double two-way trade in three years from the present level of \$26.8 billion, according to US Trade Representative Rob Portman. The high-level trade policy group was looking into the issue of US allowing entry to refurbished Indian computers, as also lifting anti-dumping duty on Indian shrimp.

Portman said five sub-groups had been set up under the high level group for deepening of economic cooperation in agriculture, tariff and non-tariff barriers, services, investment and Intellectual Property Rights issues.

He said US companies were keen to invest in India in sectors like infrastructure and there was immense scope and hoped that there would be substantial increase in foreign direct investment.

According to Commerce Minister Kamal Nath both sides were keen on ensuring that the modalities for agriculture and other key areas are worked out before the April 30 deadline at the WTO.

India, Chile conclude trade pact

India and Chile have opened a new chapter in their economic relations by concluding a Preferential Trade Agreement (PTA) that enables exchange of goods on concessional rates of duty to boost bilateral trade. Union commerce and industry minister Kamal Nath said that the PTA would take bilateral trade to a higher plane, as the next few years would witness a substantial growth in two-way trade. In 2004-05, total trade between India and Chile stood at \$447.54 million. The PTA provides tariff preferences ranging from 10% 50% on 178 tariff lines to Chile and a similar range of preferences on 296 tariff lines to India. It would benefit 98% of the items being exported by Chile to India and 91% of the goods being exported by India to Chile currently. The Indian products, which would benefit include textiles, chemicals, pharmaceuticals, engineering and agricultural machinery.

External Sector: Foreign Trade April – November

Region/Country	Export			Import		
	US \$ million		% change	US \$ million		% change
	2004	2005	2005	2004	2005	2005
World	49476.7	58830.6	18.91	66310.8	86666.6	30.70
Africa	3237.2	4143.0	27.98	2351.0	2820.9	19.99
Egypt	256.1	351.9	37.38	100.1	160.2	59.97
Kenya	264.6	274.1	3.57	29.4	28.6	-2.72
Mauritius	139.4	111.7	-19.86	5.3	4.2	-20.01
Nigeria	356.4	526.3	47.66	40.1	41.3	3.14
South Africa	650.9	966.3	48.46	1197.9	1514.9	26.46
America	10638.1	12410.1	16.66	5600.9	6744.1	20.41
Brazil	430.5	683.9	58.87	511.2	612.3	19.77
Canada	526.6	563.9	7.10	411.2	549.5	33.63
Mexico	247.3	236.4	-4.44	47.7	52.2	9.52
USA	8767.1	10095.7	15.15	3939.8	4603.4	16.84
Asia (excl. Middle East)	14957.7	18577.8	24.20	15971.3	19659.7	23.09
Bangladesh	963.6	921.8	-4.33	28.5	43.9	54.06
China	2482.4	3467.6	39.69	4181.4	5963.1	42.61
Hong Kong	2249.6	2823.7	25.52	1009.0	1349.3	33.72
Indonesia	754.7	773.3	2.47	1607.7	1669.4	3.83
Japan	1229.5	1373.6	11.72	1912.6	2031.0	6.19
Korea DPR (North)	106.4	18.8	-82.28	1.6	0.3	-81.95
Korea Republic (South)	606.0	887.1	46.38	1989.7	2502.6	25.78
Malaysia	692.5	632.0	-8.74	1433.4	1393.8	-2.76
Nepal	516.9	530.4	2.61	207.3	246.9	19.08
Philippines	245.6	281.4	14.58	127.8	127.1	-0.59
Singapore	2233.5	3555.3	59.18	1554.4	1836.4	18.15
Sri Lanka	892.5	1262.1	41.41	197.1	321.1	62.96
Taiwan (Taipei)	385.9	331.5	-14.08	679.3	837.7	23.32
Thailand	520.7	626.5	20.32	506.9	716.5	41.33
Viet Nam	330.7	341.3	3.21	58.8	78.3	33.23
Middle East	7627.2	8416.2	10.34	4915.6	6211.8	26.37
Iran	803.5	623.7	-22.38	240.7	410.9	70.69
Iraq	74.2	64.0	-13.80	0.6	1.1	82.71
Israel	653.2	746.4	14.27	549.6	644.1	17.20
Kuwait	253.9	301.1	18.62	154.0	253.9	64.90

Saudi Arabia	878.1	1054.3	20.06	805.0	919.0	14.16
UAE	4176.7	4681.7	12.09	2426.4	2928.0	20.67
Europe	12218.3	14574.9	19.29	15504.6	20252.5	30.62
European Union	10366.1	12548.1	21.05	10540.1	13372.6	26.87
Belgium	1534.1	1677.4	9.35	2685.2	3262.7	21.51
Denmark	173.7	218.4	25.77	156.8	212.0	35.15
France	1001.0	1174.5	17.34	765.7	905.4	18.24
Germany	1664.8	1931.4	16.02	2346.8	3344.7	42.52
Italy	1284.7	1322.1	2.91	803.6	1013.0	26.06
Netherlands	932.0	1427.0	53.12	450.0	631.2	40.29
Spain	799.0	881.8	10.37	238.8	322.0	34.80
Sweden	143.3	178.1	24.27	636.8	598.7	-6.00
UK	2217.6	2962.4	33.59	1955.7	2486.5	27.14
Other European Countries	1852.1	2026.8	9.43	4964.5	6879.8	38.58
Russia	382.2	419.2	9.67	808.6	1330.0	64.49
Switzerland	349.3	276.6	-20.80	3315.3	4284.2	29.22
Turkey	438.2	538.9	22.99	87.6	128.8	46.93
Oceania	530.9	620.9	16.96	2382.7	2983.0	25.19
Australia	445.6	494.7	11.02	2256.9	2824.8	25.16