INDIAN Economy & Policy WATCH

Week ended April 08, 2006 Issue No: 54 FY2006

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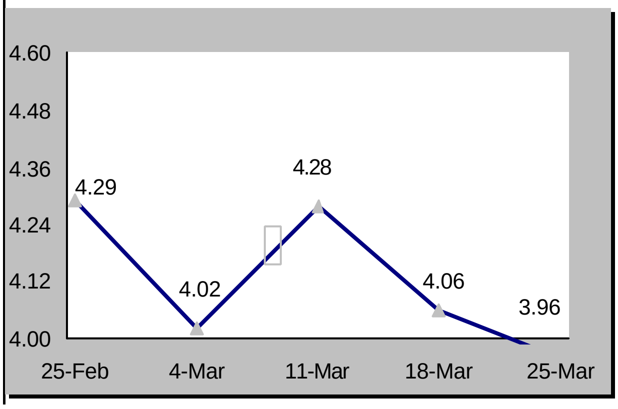
- 5 BJP-ruled States switch to VAT
- Foreign currency reserves soar by US$ 2.96 billion

IRIS

ECONOMIC INDICATORS



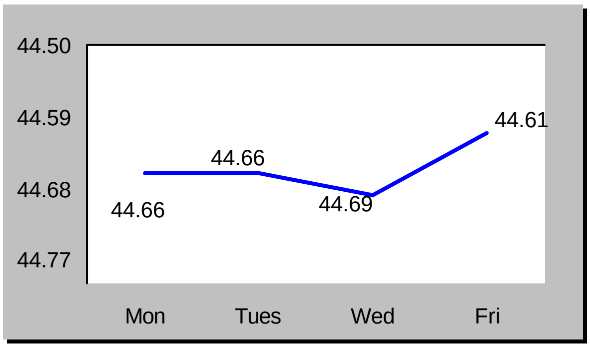
Inflation

Inflation for the week ended March 25 fell marginally to 3.96 per cent compared with 4.06 per cent for the previous week mainly on account of fall in the prices of manufactured goods.

The wholesale price rise was down to 3.96 per cent despite increase in prices of essential items like vegetables, wheat and fish, according to data released by the government today.

Inflation was 5.10 per cent during the corresponding week of the previous year.

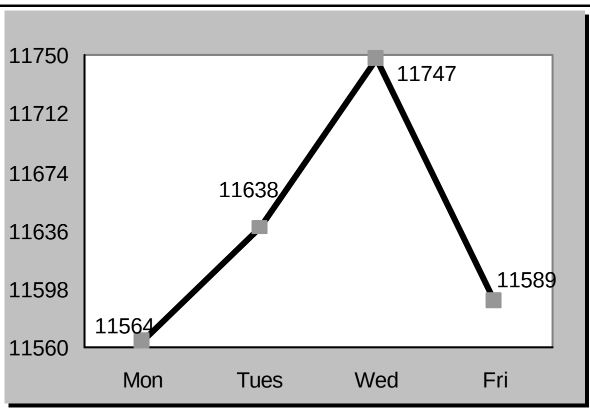
The wholesale price index (WPI) declined by 0.2 per cent to 197 points and stood at 189.5 points for the same period last year.



Rs v/s US $

The rupee stood 0.16 percent down at 44.69 per dollar from 44.62 per dollar over the week. Sustained dollar buying by PSU banks kept the rupee under pressure.

The rupee failed to take advantage of the dollar's weakness against the euro and strong FII inflows in the domestic stock indices as the RBI absorbed most of the inflows, as in the past few weeks, through PSU banks and dragged the rupee near 3-month lows.



BSE Sensex

The BSE Sensex commenced the month of April on an optimistic note by garnering 310 points in the first week to close at 11589.44. Cement, IT and pharma stocks witnessed buying this week.

The Sensex made a whopping gain of 284 points on Monday while on Tuesday it rose 74 points. The benchmark index shot up 109 points onWednesday. The market was closed on Thursday on account of Ram Navami. On the final trading day of the week, the Sensex opened firm and breached the 11900 mark in the opening trades on the news that software major infosys was considering bonus issue. Heavyweight, Infosys stock shot up 9% as investors went on a buy ing spree, which had an impact on the Sensex.

Economy & its sectors

5 BJP-ruled States switch to VAT

State-level value added tax (VAT) implementation has almost achieved nation-wide coverage, with the five BJP-ruled States switching over to the new tax regime from the existing sales tax system.

The five States that have implemented VAT from Saturday are Rajasthan, Gujarat, Madhya Pradesh, Chattisgarh and Jharkhand. These States had already completed the legal groundwork for VAT implementation.

Thus, 30 States and Union Territories have so far implemented State-level VAT. As many as 19 States and Union Territories had ushered in State-level VAT on April 1, 2005 - the date that was set by the empowered committee of state finance ministers on VAT for introduction of this new tax system.

Haryana had implemented VAT in 2003. While Meghalaya and Assam implemented VAT from May 1, 2005, Manipur did it in July and Uttaranchal on October 1. Chandigarh implemented VAT from December 15.

Only two States - Uttar Pradesh and Tamil Nadu - and the Union Territory of Pondicherry are yet to implement this new tax regime. Both Andaman and Lakshwadeep do not have a sales tax system.

Govt confident of holding price line: Chidambaram

The Government is confident of maintaining price stability despite high international oil prices.

Speaking to newspersons today, the Finance Minister, P Chidambaram: "Inflation is 3.96 percent. Any rate under four percent is a welcome development."

However, he added, the Government was concerned about high international oil prices that are currently close to $65 a barrel. Nevertheless, price stability will be maintained, he said.

Referring to the strike by employees of SBI, the Finance Minister said: "There is no justification for the strike. There is no need to inconvenience customers."

He also said that the unions had pointed out to anomalies in the agreement entered into 2002 when the NDA Government was in power. "They (unions) have put forward suggestions and the management is looking into it."

The strike relates to pension benefits to SBI employees, who get three benefits - gratuity, contributory provident fund, and a pension, unlike other public sector bank employees who get only two benefits. "When negotiations are on, where is the need to inconvenience customers?"

Chidambaram refused to comment on speculations on a possible reduction in the cash reserve ratio, after his meeting with the Reserve Bank of India officials on Wednesday.

But he said that discussions on the Credit Policy were "routinely done with the RBI."

Earlier, speaking at the inauguration of the inauguration of the World Customs Organisation, Information Technology Conference, the Finance Minister said that Customs could cease to be a long-term source of revenue for the Government.

Currently, Customs duties account for about 20 percent of the Government's tax revenues.

Instead, the focus of Customs would be on enforcement and facilitation of international trade, he added.

India is a significant contributor to the WCO's efforts in standardisation and harmonisation of data requirements. This was for development of a WCO Customs data model and in the formation of ICT guidelines under the Kyoto protocol.

Other areas of contribution are in the use of PKI (public key infrastructure) technology for ensuring security and helpdesk management in an Internet-based environment.

With increased risk management techniques in place, cargo clearance would be done in a matter of hours rather than days. For this purpose, some reengineering and restructuring of the Customs Department was under way, he said. This is expected to be completed within a year. Such advances could create opportunities for the Indian IT sector, since Customs would be outsourcing the business. "But they will have to compete for a slice of that business."

External sector

FOREIGN EXCHANGE RESERVES

Forex reserves decline $6.1 b on valuation loss

There was a decline of $6.1 billion in forex reserves on account of valuation loss in the April-December 2005 period as against a valuation gain of $4.7 billion in the corresponding period of the previous fiscal.

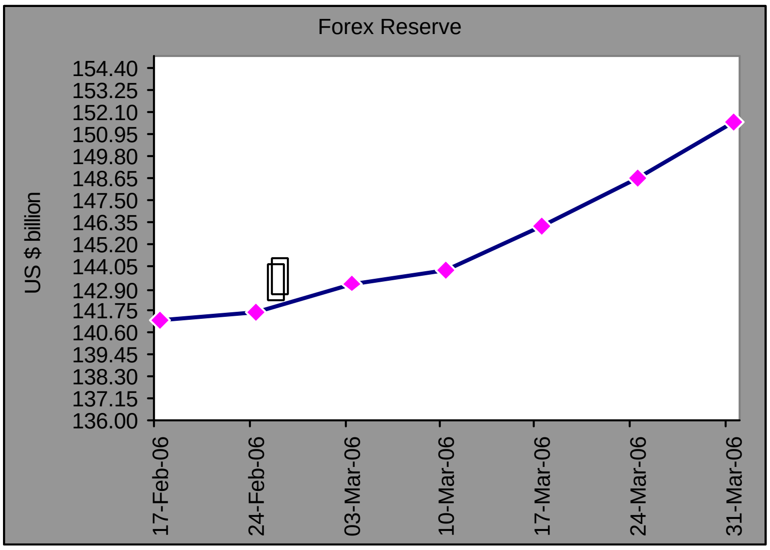
Valuation loss represents the depreciation of major currencies against the dollar. The Reserve Bank of India provided this information through a statement on sources of accretion to forex reserves. The composition of various currencies in the reserves, however, remains a secret.

Higher inflows of foreign investments at $12.9 billion in the April-December 2005 period compared with $7.8 billion in the corresponding previous period helped neutralise partially the impact of the outflow on account of repayment of Indian Millennium Deposits raised by SBI earlier. The capital account balance at $15.3 billion in December 2005 was sharply lower compared with $19.4 billion in the corresponding previous period. The current account deficit for the April-December 2005 period was higher at $13.5 billion compared with $5.9 billion in the corresponding previous period.

Reserves during the April-December 2005 period declined $4.3 billion compared with an increase of $18.2 billion in the corresponding previous period.

Forex reserves were at $137 billion in December 2005 and were the sixth largest holding by a country or central bank in the world.

Reserves have since increased over the past three months by another $11 billion. India's forex reserves are exceeded now only by Russia, South Korea, Taiwan, Japan and China.



Money & Banking

INTEREST RATES & DEBT MARKET

Gilts wary ahead of twin auctions

Gilts prices trended weaker at the beginning of the week as uncertainties about interest rate direction and the upcoming borrowings weighed on market sentiment. The bearish interest rates outlook on expectations of further rate hikes by the US Federal Reserve continued to sustain selling pressure in the market.

The jitteriness ahead of the first auction of the new fiscal compounded market grief. The yield on the actively traded 8.07% 2017 closed at 7.55%, up from its previous closing level of 7.53%.

Gilts prices recovered on Tuesday, April 4 even as traders braced for fresh issuances. Gains were more pronounced at the shorter end of the curve as liquidity improved but interest rate concerns muted demand for long-term bonds. The yield on the actively traded 8.07% 2017 eased to 7.54% from its opening level of 7.56%.

Gilts prices gained on speculations on Wednesday that an increase in government spending would help ease a cash shortfall in the banking system and this in turn might aid fresh issuances to sail through. Interest rate worries and tight liquidity conditions had taken a toll on the market in the past few weeks and had pushed up yields near to their 4-year highs.

The yield on the actively traded 8.07% 2017 slipped to 7.51% from its opening level of 7.55%.

Gilts prices erased early gains on the last trading day of the week and closed flat as traders chose to exercise caution ahead of Monday's twin auctions. Improved money market liquidity and growing speculation that an increase in government spending would further help ease a cash shortfall in the banking system had aided market to open bid.

A drop in the inflation rate below 4% helped sentiment but failed to induce buying interest as bearish interest rate outlook weighed on the market. The yield on the actively traded 8.07% 2017 closed at 7.54%, off an opening level of 7.53%.

The RBI is scheduled to sell a new 10-year paper for Rs 5,000 crore through yield-based auction and a 7.50% 2034 paper for Rs 3,000 crore through a price-based auction on April 10.

Call rates lower on increased government spending

Call rates closed the first week of the new financial year at 5.55-5.65%, around 125 bps lower from their previous closing level of 6.70-6.90%.

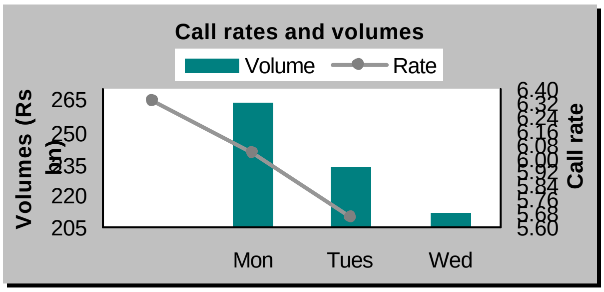
Increased government spending towards salary payments amidst lower fund requirements resulted in abundant cash surpluses with the banking system. Moreover, with the RBI's intervention in the forex market, liquidity in the banking system moved to a comfortable zone.

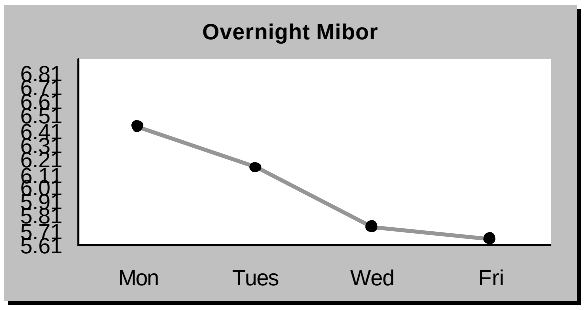
Rupee down, held in check by RBI

The rupee stood 0.16 percent down at 44.69 per dollar from 44.62 per dollar over the week. Sustained dollar buying by PSU banks kept the rupee under pressure.

The rupee failed to take advantage of the dollar's weakness against the euro and strong FII inflows in the domestic stock indices as the RBI absorbed most of the inflows, as in the past few weeks, through PSU banks and dragged the rupee near 3-month lows.

The volumes were on the lower side as traders from State Bank of India stayed away from the market in a strike demanding an increase in their pension.





Stock Markets

Weekly Wrap : Sensex surges 310 points

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Inflation for the week ended March 25 fell marginally to 3.96 per cent compared with 4.06 per cent for the previous week mainly on account of fall in the prices of manufactured goods.

FIIs invested $208.2mn in equities and mutual funs invested in equities to the tune of Rs 332.22 crore(Monday to Wednesday).

On the corporate front:

Larsen & Toubro Ltd rose 8.64% in the week on reports that the company secured two contracts this week. One from from a major power generation company in China for supply of critical gasification equipment valued at Rs 368 crore (USD 82 million) and another road project from NHAI worth Rs 5500 million.

Bharat Heavy Electricals Ltd gained 5.78% on the news that the company posted 70% growth in net profit to Rs 1,621 crore in 2005-06 as compared to Rs 953 crore in 2004-05. The turnover has shot up by 39 per cent from Rs 10,336 crore to Rs 14,410 crore. The overall order inflow stands at Rs 18937 crore.

Hero Honda reported 13.71% growth in yearly sales at 29,08,084 units for the financial year 2005-06 as against 25,57,385 in the previous year.

Maruti Udyog Ltd sold a record 522664 vehicles in the domestic market during the year, the highest since inception. In all, the company sold 561822 units. This included export of 34784 units.

PSL Ltd., an enabler in the infrastructure and construction industry, has bagged a $19 million order from the Sultanate of Oman for supplying steel pipes.

Sasken Communication Technologies advanced 8.64% on reports that the company acquired 100% stake in Chennai-based integrated SoftTech Solutions (iSoftTech). The deal places the enterprise value of iSoftlech at USD 1.45 Million.

Hindustan Construction Company bagged a contract for Rs 3171.10 million from National Highways Authority of India, New Delhi for construction of four laning of National Highways.

IL&FS Investment Managers` board approved to issue bonus shares in the ratio of one equity share for every two equity shares held.

3i Infotech was up 1.37%, the firm acquired Bangalore-based Datacons for Rs 40 crore.Datacons offers products in banking, financial services and insurance (BFSI) and retail & distribution segments.

On the macroeconomic front, India is targeting export growth of 20 per cent with additional two million employment generation in fiscal 2006-07.

Rights issues: Disclosure norms eased

Listed companies will now have the flexibility of not disclosing the price band or the offer price of the rights issue at the time of filing the draft offer letter with the market regulator SEBI.

This relaxation forms part of new steps taken by SEBI to make the domestic primary market "more transparent and efficient" through amendments in the SEBI Disclosure and Investment Protection Guideline 2000.

Under the new provisions, which will have immediate effect, the market regulator said the companies could reveal the price band (or issue price) on rights issue at any time prior to the filing of prospectus with the Registrar of Companies.

Till now, companies were required to inform the price band (or offer price) on rights issue at the time of filing the draft offer letter with SEBI.

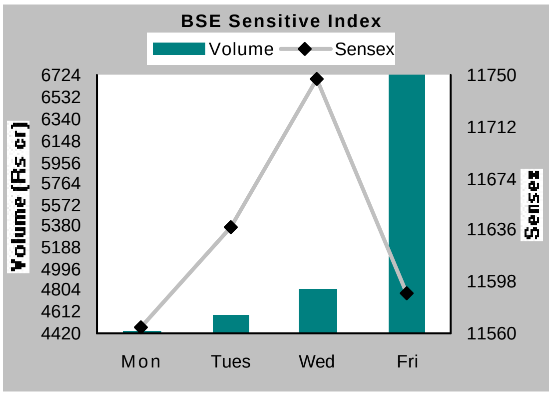
The regulator also allowed companies to issue fresh shares after filing the draft offer document "provided full disclosures in regard to the total capital to be raised from such further issues is given in the draft offer document", the regulator said in a circular here.

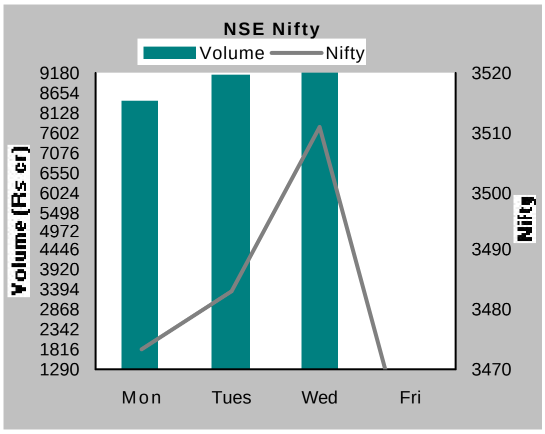
At present, a company is prohibited to make further issue of shares after filing a draft offer document with SEBI till the listing of these shares.

The market regulator also rationalised the disclosure norms on rights issue and follow-on issues as these companies "are regular in filing periodic returns with stock exchanges and have a comprehensive investor grievance mechanism in place to redress investors' complaints," the SEBI circular to merchant bankers and stock exchanges said.

Under the latest amendments, listed companies that come out with rights offer are also permitted to dispatch an abridged letter of offer to its shareholders as against the current practice of sending entire letter of offer to all shareholders.

However, the issuer company shall provide the detailed letter of offer to any shareholder upon request, SEBI said.





Inflation

Cheaper manufactured items bring down inflation

The annual wholesale price index-based inflation rose 3.96 percent during the week ending March 25, slowing from the previous week's annual rise of 4.06 percent.

The dip in the year-on-year inflation rate was largely due to lower manufactured product prices, according to data released by the Ministry of Commerce and Industry.

The Wholesale Price Index (WPI) fell 0.2 percent to 197 points during the latest reported week. The index stood at 189.5 points a year ago. The inflation rate was at 5.10 percent during the corresponding week of the previous year.

On a disaggregated basis, the Primary Articles' group index rose 0.6 percent to 193.1 points during the latest reported week. The fuel, power, light and lubricants group index remained unchanged at its previous week's level of 316.3 points.

The manufactured products' group index declined 0.6 percent to 171.7 points.

Among the Primary Articles' group, the Food Articles' group index rose 0.8 percent to 195.3 points due to higher prices of condiments and spices (3 percent), moong, fish-inland, arhar and fruits and vegetables (2 percent each) and urad, mutton, wheat, pork and gram (1 percent each). However, the prices of jowar declined one percent.

The index for Non -Food Articles' group rose by 0.1 percent to 174.7 points due to higher prices of mesta, rapeseed and mustard seed and safflower (one percent each).

However, the prices of raw silk (16 percent), sunflower (3 percent) and cottonseed (1 percent) declined.

Among the Manufactured Products' group, the index for `Food Products' group declined by 1.3 percent to 178.3 points due to lower prices of unblended black tea leaf (23 percent), soyabean oil (7 percent) and unrefined oil, khandsari, coconut oil, biscuits and oil cakes (1 percent each). However, the prices of salt (8 percent), rice bran oil (4 percent) and gingelly oil (1 percent) moved up.

The index for the Leather and Leather Products' group declined by 5.1 percent to 159.5 points due to lower prices of footwear western type.

The Government also revised downwards the final inflation figure to 4.04 percent for the week ended January 28 from provisional 4.30 percent, while WPI stood corrected at 195.9 points as against the earlier estimate of 196.4 points.

INDIAN Policy WATCH

April 08, 2006

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HIGHLIGHTS

- Export target set at $120 b; sector-specific steps unveiled
- Cabinet clears National Urban Transport Policy
- TRAI shoots down COAI plea to review past decisions

C O N T E N T S

POLICY WATCH

POLICY WATCH

FOREIGN TRADE

Export target set at $120 b; sector-specific steps unveiled

Unveiling a slew of measures to put Indian exports on a higher growth trajectory and create greater employment opportunities, the Annual Supplement to the Foreign Trade Policy (2004-09) has come up with sector-specific initiatives to make India a hub for gems and jewellery exports and a major refuelling stop for international flights.

Releasing the Annual Supplement on Friday, the Commerce and Industry Minister, Kamal Nath, set a 20 percent merchandise export growth target (about $120 billion) for 2006-07. He expected India's exports to exceed $150 billion by 2009.

Kamal Nath pointed out that India's exports had recorded annual growth of over 25 percent during the last two fiscal to touch the `auspicious figure' of $101 billion in 2005-06.

Two new `WTO-compatible' schemes - Focus Product Scheme (FPS) and Focus Market Scheme (FMS) - have been introduced with the aim to promote specific products and overseas export markets, respectively, and to provide employment in semi-urban and rural areas.

While the scheme focussing on specific market allows duty credit facility at 2.5 percent of the f.o.b. value of exports of all products to notified countries mainly in Latin America and Africa, the Focus Product Scheme allows similar benefit on the f.o.b. value of exports on 50 percent of the export turnover of notified products such as value added fish and leather products, stationery items, fireworks, sports goods, handloom and handicraft items.

Queried on the employment growth target for the current fiscal, Mr Kamal Nath said that the initiatives could generate an additional two million jobs in the current year.

A new scheme `Duty Free Import Authorisation Scheme' has been launched to enable exporters to import the required inputs before exports and also allow them to transfer the scrip once the export obligation is completed. The scheme clubs the existing Advance Licence Scheme (ALS) and the Duty Free Replenishment Certificate (DFRC) scheme. DFRC would be phased out from April 30.

Imports made under this authorisation would be exempt from payment of basic customs duty, additional customs duty, education cess, anti-dumping duty and safeguard duty, if any.

To make India a major refuelling stop, the Annual Supplement has now said that supplies to international flights would be treated as exports.

As an export facilitation measure, the Annual Supplement has also extended the export obligation period under the export promotion capital goods scheme (EPCG) by two years. Moreover, certain flexibilities have been introduced in the conditions relating to maintenance of average export performance under the EPCG scheme.

To encourage services exports, a number of features have been added in the `served from India scheme' including the benefit of transfer of both the scrip and imported input to a group service company. Hitherto, transfer of imported material was only allowed.

Kamal Nath said that India's non-oil imports for 2005-06 stood at $97 billion and the oil import bill stood at $ 43 billion. He pointed out there was no non-oil trade gap during the year.

"We expect our non-oil trade surplus to be in excess of $ 4 billion next year," he said.

TRANSPORT

Cabinet clears National Urban Transport Policy

The Union Cabinet has approved the National Urban Transport Policy that seeks to encourage integrated land use and transport planning in cities, and focuses on greater use of public transport and non-motorised modes by offering central financial assistance.

The Defence Minister, Pranab Mukherjee, stated this after a meeting of the Union Cabinet.

The policy incorporates urban transportation as an important parameter at the urban planning stage. It emphasises on integrated land use, transport planning to minimise travel distance, access to livelihood, education and other social needs, especially for the marginal segments of the urban population. The policy also looks to improve access of business to the markets and various factors of production.

The policy's objective is to ensure safe, affordable, reliable and sustainable access for a growing number of city residents to education and employment. In this regard, the policy brings about an equitable allocation of road space, with people, rather than vehicles, as its main focus.

It would also enable the establishment of quality-focused multi-modal public transport systems that are well integrated and providing seamless travel across modes.

The policy involves establishing effective regulatory and enforcement mechanisms that provide a level playing field for all operators of transport services and enhanced safety for the users of transport systems. It aims to introduce an intelligent transport system for traffic management.

Other thrust areas include establishing institutional mechanisms for enhanced co-ordination in the planning and management of transport systems, besides addressing concerns of road safety and trauma response. It also talks about raising finances through various mechanisms that tap land as a resource for investment in urban infrastructure, reducing pollution through changes in travelling practices, stricter norms and technological improvement.

It calls for roping in the private sector and tapping its strengths. The policy also entails pilot projects that demonstrate the potential of possible best practices in sustainable urban transport.

The transport policy assumes significance given the projection that India's urban population would grow to about 473 million in 2021 and 820 million by 2051 from 285 million in 2001.

TRAI shoots down COAI plea to review past decisions

The Telecom Regulatory Authority of India (TRAI) has shot down a request from the Cellular Operators Association of India (COAI) to review some of the decisions taken by the regulator under Pradip Baijal.

A COAI delegation had made a fresh presentation to the new TRAI Chairman, Nripendra Misra, seeking a review on the regulator's earlier decisions including those on lifetime validity schemes, number portability, termination charges, and differential tariffs.

According to sources, the TRAI Chairman took a position of moving forward rather than looking back at decisions taken by the earlier board.

The COAI had met the regulator on March 30 and suggested a higher mobile termination charge for operators on incoming calls. It said that the termination charges in other countries were much higher, which placed Indian operators at a disadvantage.

However, the TRAI said that it was unfair to increase the termination rates since all tariffs had moved to a cost-based system. The COAI also suggested revoking TRAI's earlier decision barring cellular operators offering lifetime validity plans from changing the tariff as long as the operators remained in business.

The TRAI, however, took the view that operators needed to be more transparent with customers while offering tariffs.

TRAI said that the differential tariff by cellular operators was negating the Government's decision to merge the Chennai, Kolkata, and Mumbai circles with respective States.

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