INDIAN Economy & Policy WATCH
Week ended April 22, 2006 Issue No: 56 FY2006

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IRIS

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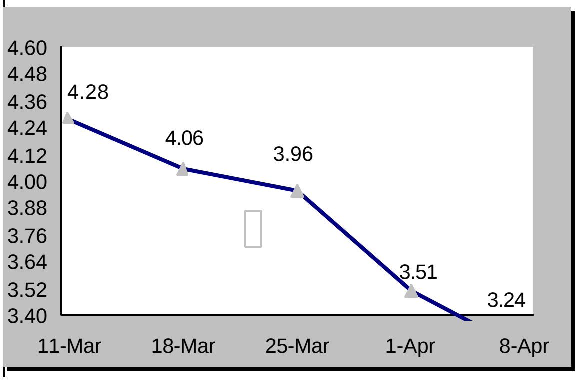
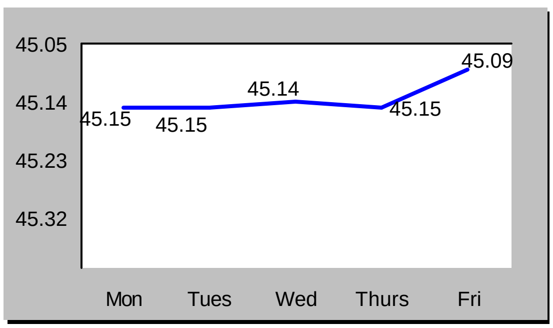


Inflation

The annual wholesale price index-based inflation rose 3.24 percent during the week ending April 8, lower than the previous week's annual rise of 3.51 percent.

The lower increase in the year-on-year inflation rate was mainly on account of cheaper food items including vegetables and wheat, according to data released today by the Ministry of Commerce and Industry.

The WPI ended the latest reported week at 197.6 points, up from 191.4 points during the corresponding period last year. The inflation rate was higher at 5.86 percent during the corresponding period of the previous year.

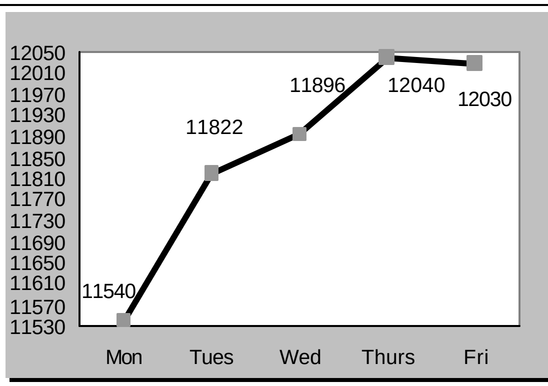


Rs v/s US $

The rupee rose marginally against the dollar on Monday as foreign fund flows into the stock market neutralised demand for the U.S. unit from state-run banks and oil firms.

Indian shares rebounded nearly 3 percent on expectations of robust earnings from the country's largest software services firm, and most shares recorded smart gains.

The rupee closed at 45.1250/1350 per dollar marginally up from Thursday's close of 45.1650/1800.



BSE Sensex

The markets made a whopping gain of 793 points on the back of good fourth quarter results from corporates. The BSE Sensex started the week on a firm note and rallied throughout the week except for Friday when it closed flat.

The Sensex leaped 302 points on Monday on the support of heavyweight Infosys, which came out with its fourth quarter results on Friday. The software outfit had recommended 1:1 bonus issue which led the markets on a frenzy. The Sensex gained 282 points and 74 points on Tuesday and Wednesday respectively. On Thursday the Sensex added 144 points breaching the 12000 mark, while on Friday it closed flat losing 9 points.

Economy & its sectors

India should target 10% GDP growth: PM

The Prime Minister, Dr Manmohan Singh, said on Tuesday that a growth rate of 8 percent for the GDP was not only sustainable but the country could also "realistically hope to target a growth rate of 10 percent per annum."

At the annual conference of the Confederation of Indian Industry (CII), the Prime Minister said the Government would formulate policies for the manufacturing sector to attain at least 12 percent annual growth.

He said the manufacturing sector holds the key to acceleration of employment generation and national income.

For strengthening the manufacturing sector, Dr Singh said he had constituted a high-level committee on manufacturing under his chairmanship.

"This committee will make recommendations and review the implementation of policies formulated under the National Manufacturing Initiative."

Dr Singh also said the Government had constituted a task force to focus on the growth of electronics and IT hardware manufacture.

Also, "to maintain the vibrancy of the telecom sector, we have set up a Group of Ministers to enable early vacation of spectrum by existing Government users. We hope to make this capacity available for commercial use in a time bound manner," he said.

He said he was aware of the need of labour market flexibility and would evolve a consensus to address the issue in the future.

With regard to infrastructure development, the Prime Minister expressed happiness over greater private participation through the build, operate, transfer (BOT) route in the national highway programme.

"We recently contracted three major BOT stretches of the National Highway Development Programme with large negative viability gap funding."

He added, "You are aware that we are working to build dedicated railway freight corridors. These, along with the initiative to allow private container trains, will transform the face of the Indian logistics."

For the growth of the farm sector, Dr Singh emphasised the need to promote land reforms. Land reform is a State subject but a national priority that requires national consensus, he said, adding that "redistribution of land and tenancy reform could improve the income and asset base for the rural poor. It could generate demand for rural housing and other infrastructure."

In his welcome address, the CII President, YC Deveshwar, said CII's focus on sustainable competitiveness has become the basis for a variety of private-public partnerships in the country.

He said effective skills development, preservation of natural capital and private participation in rural economic development hyphenate CII's efforts to promote sustainable competitiveness.

In his address, the past President of CII, Brijmohan Lall Munjal, said the Government needed to not only improve physical infrastructure but also price it appropriately.

The Vice-President of CII, R Seshasayee, in his concluding remarks, said the industry is increasingly focusing on innovation, development of new products and creation of intellectual properties.

He said that a task force set up under JJ Irani is developing the action points for education, skills development, employment generation and other social development issues.

External sector

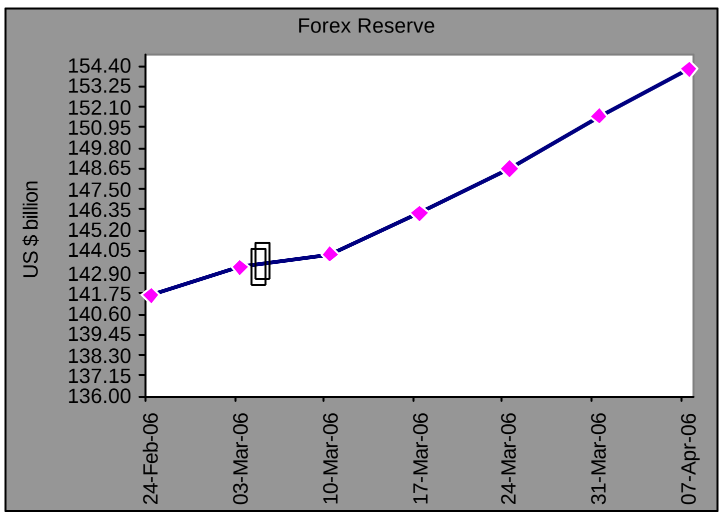
FOREIGN EXCHANGE RESERVES

Foreign currency reserves up by US$ 987 million

India's total foreign exchange reserves rose by US$ 987 million to US$ 155.196 billion for the week ended April 14. Foreign currency assets increased by $989 million to touch $ 148.681 billion during the week according to the RBI's weekly statistical supplement released on April 21.

Gold reserves and SDRs were unchanged at $5.75 billion and $3 million respectively.

The reserve position in the IMF fell by $2 million to touch $757 million.



Money & Banking

INTEREST RATES & DEBT MARKET

Gilts volatile in policy week

Gilts eased to near four-year lows on Monday on thin volume, with traders nervous high oil prices could prompt the central bank to raise interest rates at its policy meeting on Tuesday.

The yield on the 10-year bond rose to 7.56 percent from the previous close of 7.54 percent.

Gilt prices closed sharply higher on Tuesday on relief that the central bank kept interest rates unchanged at its policy review, when many in the market had expected a rise.

The yield on India's benchmark 10-year bond fell to finish at 7.41 percent from Monday's close of 7.55 percent.

Indian government bond yields fell to a near-three-month low on Wednesday helped by Standard and Poor's move to raise the outlook on India's rating to positive from stable.

The yield on India's benchmark 10-year bond closed at 7.30 percent, the lowest since Jan.24 and down from Tuesday's close of 7.41 percent.

Indian bond prices ended a two-day rally to close lower on Thursday as investors booked profits ahead of fresh issues worth Rs 10,000 crore ($2.2 billion) and jitters over record high oil prices.

The yield on India's benchmark 10-year bond ended at 7.34 percent, up from Wednesday's close of 7.30 percent.

Gilt prices ended higher at near three-month highs on Friday on expectations that easy liquidity conditions in the money market would help the government's borrowing plan for next week go through easily. But gains were limited on concerns that record-high oil prices would trigger inflation expectations in a robustly growing economy.

India's central bank will auction a 7.40 percent bond maturing in 2012 for Rs 6,000 crore ($1.3 billion) and a 7.95 percent 2032 bond worth Rs 4,000 crore on Tuesday.

The yield on the benchmark 10-year bond eased to close at 7.32 percent on Friday, down 2 basis points from the previous close.

Call rates down slightly

Call rates closed Monday at 5.55-5.65%, down from their previous close of 5.60-5.70%.

Rates dropped further on Tuesday to 5.50-5.60% and maintained this level following the credit policy statement from the central bank which left the key rates unchanged.

Rupee held in check by state-run banks

The rupee rose marginally against the dollar on Monday as foreign fund flows into the stock market neutralised demand for the U.S. unit from state-run banks and oil firms.

Indian shares rebounded nearly 3 percent on expectations of robust earnings from the country's largest software services firm, and most shares recorded smart gains.

The rupee closed at 45.1250/1350 per dollar marginally up from Thursday's close of 45.1650/1800.

The Indian rupee ended weaker on Tuesday as the central bank left short-term interest rates steady and dealers noted increased demand for dollars from domestic oil firms against the backdrop of a spurt in global crude prices.

The rupee, which began trading on a firmer footing, weakened over the day and closed at 45.175/185 a dollar compared to Monday's close of 45.1225/1325.

The rupee rose on Wednesday after Standard and Poor's raised the outlook on India's rating to positive from stable, which lifted the stock market to a new peak.

India's central bank intervened to buy most of the foreign capital inflows into the stock market, but traders said it stopped buying dollars towards close of trade, helping the rupee finish firmer.

The rupee ended at 45.09/10 a dollar, 0.18 percent higher than Tuesday's close of 45.175/185.

The Indian rupee eased on Thursday as oil importers and state-run banks bought dollars.

The rupee ended at 45.1050/1150 per dollar, a shade weaker than Wednesday's close of 45.09/10.

The Indian rupee slipped towards the bottom of the week's trading range on Friday, as state-run banks kept it under pressure, and it ended the week close to a recent four-month low.

State-run banks, likely to be operating on behalf of the central bank, bought dollars and sold rupees at about 45.10 per dollar to push the currency to a weaker close of 45.1450/1500. It ended Thursday at 45.1050/1150.

Bank credit up 3.7% in last fortnight of 2005-06

Gross bank credit touched Rs 14,96,474 crore for the financial year 2005-06, with an increase of Rs 53,883 crore in the last fortnight of the fiscal alone. This represents an increase of 3.7 percent over Rs 14,42,591 crore in the fortnight ending March 17, 2006.

According to the Reserve Bank of India's Weekly Statistical Supplement for the quarter ended March 31, 2006, food credit, dropped by Rs 38 crore to Rs 41,787 crore and non-food credit rose by Rs 53,921 crore to touch Rs 14,54,687 crore.

For the full year, bank credit has increased by almost 30 percent from Rs 11,52,210 crore in 2004-05. Banks have seen a huge credit growth in 2005-06, fuelled by the economy growing at a rate of over 7.5 percent and huge investments in sectors such as infrastructure, retail and agriculture; and capital expansion by companies. Companies raised loans to meet domestic growth and overseas expansion.

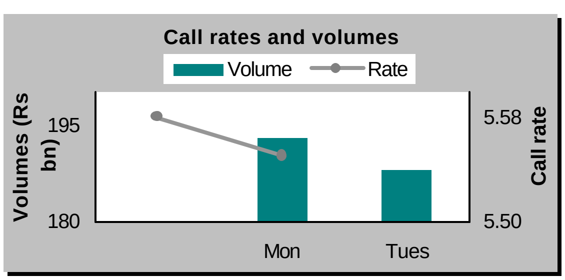
Aggregate deposit for the fortnight ended March 31, 2006 also surged by Rs 83,895 crore to touch Rs 20,87,670 crore, against Rs 20,03,775 crore in the previous fortnight.

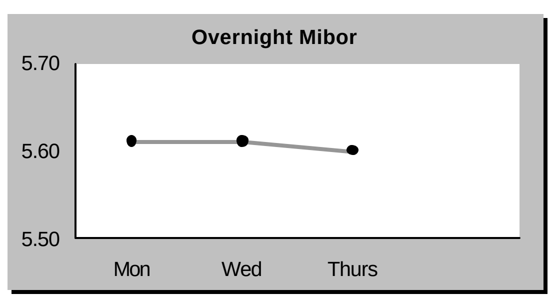
According to a public sector bank official, the increase in lending by banks during the period in consideration is mainly because they want to shore up their balance sheets before the fiscal comes to an end.

Banks do a lot of short-term lending in the last minute to show better balance sheet. Many banks also give a large number of MIBOR-related loans. This not only helps in increasing the balance sheet size, but also helps in reducing the percentage of non-performing assets to total assets, the official said.

Another reason could be the loans sanctioned to oil companies, which are being utilised now. "Oil companies have a lot of appetite for funds. It is possible that their loan limits were not fully utilised until now," the official said.

It is estimated that most banks would report a growth of around 30 cent in their loan portfolios for 2005-06. However, deposits are likely to grow by 17 percent. Most banks have raised deposit rates in addition to borrowing from the RBI to raise resources to meet the increased demand for funds.





Stock Markets

Weekly Wrap : Sensex breaches 12000 mark, vaults 793 points

The markets made a whopping gain of 793 points on the back of good fourth quarter results from corporates. The BSE Sensex started the week on a firm note and rallied throughout the week except for Friday when it closed flat.

The Sensex leaped 302 points on Monday on the support of heavyweight Infosys, which came out with its fourth quarter results on Friday. The software outfit had recommended 1:1 bonus issue which led the markets on a frenzy. The Sensex gained 282 points and 74 points on Tuesday and Wednesday respectively. On Thursday the Sensex added 144 points breaching the 12000 mark, while on Friday it closed flat losing 9 points.

Inflation fell for the second consecutive week to 3.24% for the week ended April 8 from 3.51% in the previous week mainly due to cheaper food items including vegetables and wheat.

FIIs invested $0.7mn in equities and mutual funds also were net buyers in equities to the tune of Rs 524.5 crore (from Monday to Thursday).

On the Corporate front:

Satyam Computer Services posted 35.96% rise in net profit to Rs 2899.00 million for the quarter ended March 31, 2006 as compared to Rs 2132.10 million for the corresponding quarter previous year. Total Income has increased from Rs 9786.40 million in Q4 FY 04-05 to Rs 12875.20 million for Q4 FY 05-06, registering a growth of 31.5%. Shares of Satyam gained 4.68% this week to close at Rs 808.15.

Infosys Technologies has acquired 23% stake in Progeon, the BPO subsidiary of Infosys, from Citigroup for an aggregate consideration of USD 115.13 million. Shares of Infosys gained 9.12% to close at Rs 3296.20.

Ranbaxy Laboratories Ltd has posted 25.80% decrease in profit after tax to Rs 502.40 million for the quarter ended March 31, 2006 as compared to Rs 677.10 million for the quarter ended March 31, 2005. Total Income has decreased by 2.95% to Rs 8192.20 million for Q1 FY 2006 from Rs 8441.40 million in Q1 FY 2005. Shares of Ranbaxy gained 11.9% to close at Rs 504.15.

Wipro has posted a 56% rise in net profit to Rs 6575 million for the quarter ended March 31, 2006 as compared to Rs 4214 million for the quarter ended March 31, 2005. Total Income has increased by 70% to Rs 35469 million for the quarter ended March 2005-06, compared with corresponding quarter. Shares of Wipro rose 6.52% to close at Rs 548.95.

Tata Consultancy Services Ltd (TCS) has posted 75.7% rise in net profit to Rs 7500.60 million for the quarter ended March 31, 2006 where as the same was at Rs 4267.00 million for the corresponding quarter previous year. Total Income went up by 44.9% to Rs 30771.80 million for the quarter ended March 31, 2006 where as the same was at Rs 21232.80 million for the corresponding quarter previous year. Shares of TCS went up by 10.9% to close at Rs 1994.

HDFC Bank posted a 30% rise in net profit to Rs 2632.10 million for the quarter ended March 31, 2006 as compared to Rs 2023.70 million for the quarter ended March 31, 2005. Total Income has increased by 55% to Rs 16826.50 million for Q4 FY 05-06 from Rs 10872.70 million in Q4 FY 04-05. Shares of HDFC Bank rose 5.41% to close at Rs 849.90.

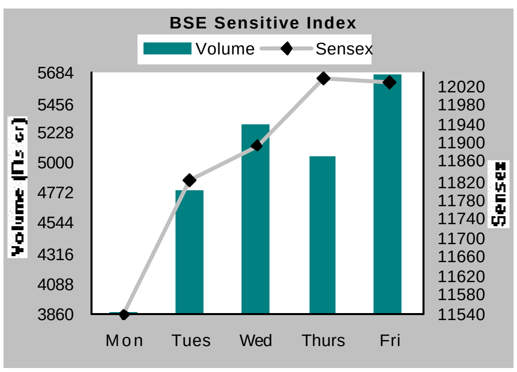
Gujarat Ambuja Cements posted 108.6% rise in net profit to Rs 2985.90 million for the quarter ended March 31, 2006 as compared to Rs 1431.10 million for the corresponding quarter previous year. Total Income (net of excise) has increased by 44.7% to Rs 9781.30 million for Q3 FY 05-06 from Rs 6757.00 million in Q3 FY 04-05. Gujarat Ambuja advanced to close at Rs 119.75.

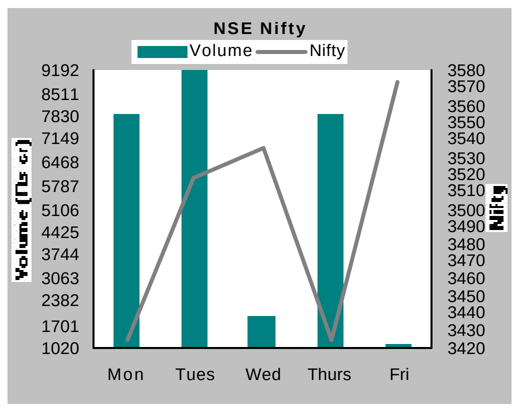
Oil and Natural Gas Corporation registered 9 per cent rise in net profit to Rs 14,175 crore during 2005-06. The turnover of the company was up 9 per cent to Rs 50,900 crore from Rs 46,712 crore in 2004-05. The company paid a subsidy of Rs 11,958 crore to oil marketing companies. Shares of ONGC gained 5.86% to close at Rs 1339.85.

On the macroeconomic front:

The RBI came out with the Credit and Monetary policy on Tuesday. Bank Rate, Reverse Repo Rate, Repo Rate and Cash Reserve Ratio kept unchanged. GDP growth for the current year is projected at 7.5-8.0%.

Foreign direct investment inflows into India jumped 41.5% to USD 7.5 billion in 2005-06 compared to USD 5.3 billion in 2004-05 million. The FDI inflows are likely to grow 25% and cross USD 10 billion in the current fiscal.





Inflation

Inflation slows on cheaper food items

The annual wholesale price index-based inflation rose 3.24 percent during the week ending April 8, lower than the previous week's annual rise of 3.51 percent.

The lower increase in the year-on-year inflation rate was mainly on account of cheaper food items including vegetables and wheat, according to data released today by the Ministry of Commerce and Industry.

The WPI ended the latest reported week at 197.6 points, up from 191.4 points during the corresponding period last year. The inflation rate was higher at 5.86 percent during the corresponding period of the previous year.

The Government revised downward the inflation figure to 3.81 percent for the week ended February 11 from provisional 4.02 percent, while WPI stood corrected at 196.2 points from the earlier estimate of 196.6 points.

On a disaggregated basis, the primary articles group index fell by 0.3 percent to 195.1 points due to cheaper food items. It was 187.1 points a year ago.

The index for food articles group declined by 0.6 percent to 197.9 points due to lower prices of eggs (20 percent), vegetables and wheat (3 percent each), pork, bajra, fruits and fish-inland (1 percent each).

The index for non-food articles group index rose by 0.2 percent to 175.2 points, even as fodder became cheaper by 1 percent. However, prices of raw cotton rose by 2 percent.

The Fuel, power, light and lubricants group index remained unchanged at the previous week's level of 316.7 points. It was 292.5 points in the year-ago period. The Manufactured products group index was up by 0.1 percent to 171.8 points due to increase in prices of food products, chemicals, non-metallic minerals and base metals. The index was 170.4 points in the year-ago period.

The Chemicals and chemical products group index was up by 0.1 percent to 189 points due to higher prices of powder other than vitamins (5 percent), calcium ammonium nitrate n-content (3 percent), liquid nitrogen (2 percent) and soda ash (1 percent), but organic pigments became cheaper by 4 percent.

The Non-metallic mineral products group index was up by 1 percent to 186.8 points due to higher prices of asbestos cement corrugated sheets (3 percent) and cement (1 percent).

Base metals alloys and metal products group index was up by 0.5 percent to 208.8 points due to higher prices of zinc (15 percent), steel sheets, plates and strips (9 percent each), other iron steel (5 percent), basic pig iron (3 percent each) and zinc ingots (1 percent).

However, tin boxes/containers became cheaper by 4 percent, while bolts and nuts by 1 percent.

The transport equipment and parts group fell by 0.2 percent to 160.1 points due to the one percent fall in car chassis prices.

INDIAN Policy WATCH

April 22, 2006

Issue No: 56 FY2006

HIGHLIGHTS

- RBI thrust on credit quality; key interest rates held steady
- Presidential nod for Finance Act
- President nod for gas regul atory Bill

C O N T E N T S

POLICY WATCH

POLICY WATCH

CREDIT POLICY

RBI thrust on credit quality; key interest rates held steady

In a clear warning to banks to improve asset quality, rather than the quantum of credit, the Reserve Bank of India has called for a slowdown in lending to sensitive sectors such as real estate and capital markets.

In its Annual Policy Statement for 2006-07, announced on Tuesday, the RBI has kept its key interest rates - reverse repo, repo and cash reserve ratio - unchanged

The RBI has also projected a lower credit growth of 20 percent for the current year against 30 percent in the last two years.

The central bank has increased the risk weight on bank exposures to commercial real estate and capital market to 150 percent from 125 percent. Banks' exposure to venture capital funds will also form part of its capital market exposure, the RBI said. Thus, banks now have to set apart more capital in their books as cover to maintain their existing level of lending to these sectors. The RBI had increased the risk weightage for these sectors from 100 to 125 percent in July 2005.

Dr YV Reddy, Governor, RBI said, "We are not taking a view on whether asset price is appropriate or not. But the growth in these sectors is such that it is better for banks to provide higher provisioning."

Loans to commercial real estate rose by 84 percent last year.

The central bank also increased the banks' provisioning for standard advances from 0.4 percent to 1 percent for personal loans, capital market exposures, residential housing of more than Rs 20 lakh and commercial real estate loans. Dr Reddy said, "There have been reports of people buying multiple homes, which could increase the risk. We had to keep a delicate balance. We felt that Rs 20 lakh is reasonable. Improvements in the housing market, such as rationalisation of the Urban Land Ceiling Act and stamp duty rates, could prompt us to reduce the risk weightage."

This move may force banks to re-price their home loan rates for high-end loans, said a bank official.

The policy projects an aggregate deposit growth at around Rs 3,30,000 crore in 2006-07.

In a move to help banks raise more deposits, the RBI has increased the ceiling in interest rates for NRE deposits for one to three years maturity to 100 basis points above Libor or Swap rates.

The central bank's annual policy indicates a possible rise in interest rates, in the event of an upturn in inflation due to pass-through of international oil prices.

"Taking into account the real, monetary and global factors having a bearing on domestic prices, containing inflationary expectations would continue to pose a challenge to monetary management," it said.

The policy has projected a lower growth of non-food credit at 20 percent in 2006-07, a `calibrated deceleration' from over 30 percent in the last two years.

Dr Reddy said, "We hope to bring growth to a reasonable trajectory by emphasising on improvement in quality, but not diluting growth. The word calibrated has been introduced deliberately."

The economy's performance in 2005-06 was better than expected and inflation has been curtailed to 5-5.5 percent, he said, adding that it was "good times" for the external sector, money market and forex markets.

For 2006-07, the GDP growth has been targeted at 7.5-8 percent, but it is critically dependent on agriculture.

"The three risks to growth are physical infrastructure, fiscal situation and agriculture. We need to ensure that investment should take place in agriculture," said Dr Reddy.

BUDGET

Presidential nod for Finance Act

The President, Mr A.P.J. Abdul Kalam, has given his assent to the Finance Act 2006 on April 18.

Consequent to the Presidential assent, the various changes made in the Budget as regards service tax would come into effect from this date.

Accordingly, service tax on all taxable services stands increased from 10 percent to 12 percent from April 18. In addition to the 12 percent, an education cess at the rate of two percent of 12 percent i.e., 0.24 percent, would also be leviable.

PETROLEUM

President nod for gas regulatory Bill

The Petroleum and Natural Gas Regulatory Board Bill, 2006, which provides for setting up of a regulator for downstream oil refining and fuel marketing, has become an Act with the President, Mr A.P.J. Abdul Kalam, giving his nod to the legislation passed by Parliament last month.

"This regulatory mechanism would facilitate uninterrupted and adequate supply of petroleum, petroleum products and natural gas in all parts of the country at fair price. It would promote competitive markets," a release said here.

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