

Weekly Macro Perspectives

March 13, 2010

(a) Agriculture

- According to Dr Rangarajan, Economic Advisor to Prime Minister, India may not need to import rice this year as the rice procurement so far is to the tune of 24 mln tonnes and there are indications that the procurement target of 27 mln tonnes could be easily met.
- According to the Ministry of Agriculture Report, India's wheat procurement in the new season that starts from April 1, is likely to touch a record 26 mln tonnes up from this year's 25.3 mln tonnes on the back of better crop conditions.
- India's vegetable oil imports are likely to rise to about 9 mln tonnes in the current oil year, ending October, up from last year's 8.6 mln tonnes on cheaper global supplies, weaker dollar and rising local demand.

(b) U.S., Europe at odds over global financial reform

- A feud between U.S. and Europe has cast doubt on the likelihood of a comprehensive global response to the financial crisis that sparked a worldwide depression.
- According to the U.S. Treasury Secretary Geithner, if the U.S. fails to take a convincing lead on financial reform, it could lead to an ineffective patchwork of global regulation.
- The chief concern is with Europe -- the world's other major capital market, where officials want to deal more rigorously with some types of activity -- effectively barring U.S.-based hedge funds from operating there, while remaining more relaxed in areas where the U. S. has taken a tougher line.
- Development of a roughly common set of regulations to govern the world's major financial centres is important, otherwise capital and investors will seek out the countries with the least restrictive rules, undermining the effectiveness of any new regulations and increasing the risk of future problems.
- The schism between the U.S. and the European Union reemerged this month when Geithner came out against new regulations on large investment funds being considered by European regulators. Differences are emerging over the regulation of derivatives. A crisis in the financing of Greek government debt has led European leaders to call for a prohibition on some forms of those investments, something the U.S. authorities are unlikely to endorse.

(c) Indian economic highlights this week

- Indian industry has posted a strong 16.7% (y-o-y) growth in Jan, 2010 on the back of a stronger growth in the production of consumer durables & capital goods. The growth has been partly aided by a low statistical base of the previous year. This is the fourth consecutive month of a double-digit industrial growth for India.
- A very high level of food price led inflation, however, has weakened the demand for consumer non-durables. Contrary to the performance of other use-based sectors, consumer non-durables' sector has posted a negative growth of 3.1% (y-o-y) in Jan, 2010.
- Cement prices are likely to go up by about Rs 20-25 a bag in various markets across the country before end of March, on strong demand and higher input prices. According to the Cement Manufacturers' Association, cement despatches have gone up to 143.67 mln tonnes during Apr'09 to Feb'10 compared with 127.79 mln tonnes in the year ago period.
- According to International Copper Association, the energy efficiency initiatives of the Government coupled with a rebound in the construction sector are expected to boost copper consumption in India. Currently, the growth in India is being driven by sectors like power, utilities, construction, appliances, agriculture, transportation, etc.
- In India, a historic attempt was made on March 9th, to redress the decade's history of gender injustice with the Rajya Sabha passing the Women's reservation bill by a 186 to 1 majority, which seeks to grant 33.0% reservation for women in the Lok Sabha and State Assemblies.
- The RBI has agreed to purchase up to US \$10 bln (Rs 45,500 crore) of IMF notes as a part of an international effort to support the fund's lending capacity. The RBI said latest purchase is a temporary bilateral agreement for an initial period of one year, which may be extended by a period upto two years.
- India has emerged as the second fastest growing investor in the U.S. after the UAE between 2004 and 2008.
- Indian banking sector's credit growth has moved up from a below 10.0% (y-o-y) growth in Oct'09 to 15.1% (y-o-y) as on Feb 12, 2010. We expect loan growth in the band of 15.0% to 15.5% in FY10, which is likely to rebound to 17.5% to 18.0% in FY11 driven by infrastructure, cement, steel, capital goods and retail sector.
- India's Foreign Exchange Reserves (FER) rose \$74 mln to \$278.431 bln for the week ended March 5 after falling for two consecutive weeks.

(d) Indian food prices up 17.81% in the week to Feb 27, 2010

- The government's weekly release showed that India's primary articles inflation (y-o-y) marginally rose to 15.08% for the week ended Feb 27, from 15.00% a week ago.
- However, food-price inflation declined slightly and rose to 17.81% from 17.87% a week ago.

- On week-on-week basis, there was an increase in the prices of cereals, fruits, vegetables, fibres, minerals and mineral oils.
- According to Dr Rangarajan, the government must release more food stocks through the public distribution system. Also, additional channels like cooperative societies must be explored to make stocks available to all segments at a price which is a little less than the market price. He expects food prices to see a reversal of the trend by the second half of 2010-11, as he anticipates a good rabi season harvest.
- We project the monthly inflation rate for February, 2010 at 10.10% (y-o-y) with the index at 250.5 primarily on account of high food prices as well as non-administered fuel prices and also higher prices of some consumer durables.

(e) Gilts to stay under pressure next week

- The yield on India's benchmark 10-year government bond (6.35% 2020) ended at 8.00% on Friday (Mar 12) versus 7.96% a week ago.
- As predicted by us in the last WMP, the yield on the current 10-year benchmark government bond rose above 8.0% twice this week as traders pulled out of the market ahead of the Feb inflation data release on Monday (Mar 15).
- Uncertainty over supply of bonds from April is also weighing on the bond market sentiment. There is also uncertainty about the benchmark status of the 2020 bond.
- According to the HSBC Economic Research Note, " Indian economy is further advanced in the economic cycle than most people believe, potentially leading to a build-up in underlying price pressures. The policy authorities have fallen significantly behind the curve and need to act much more aggressively than they have so far to clamp down on underlying inflation".
- We expect government bonds to weaken further next week against the backdrop of high growth and high inflation and expect the yield on 10-year benchmark paper in the band of 7.95% to 8.05%.

(f) Upward bias to continue for rupee next week

- Indian rupee appreciated further by 0.38% this week and ended at 45.4350 against the US dollar.
- Indian currency rose for a fifth week – the longest winning stretch since Oct, 2009 on the back of strong FII buying of Indian stocks. So far in March till 11th March, the FIIs' net purchases in Indian stocks and debt instruments stood at US \$2.94 billion.
- The rupee extended this year's gain to 2.4% -- the third best performer amongst the 10 most-active Asian currencies outside of Japan.
- Next week, we expect the positive bias to continue in rupee, as dollar is expected to weaken against the Euro and pound sterling. Any rise in local shares also augurs well for the rupee's rise. However, rising dollar demand from importers would prevent a sharp appreciation of rupee. We expect rupee in the range of 45.25 to 45.40 next week.

(g) No major breakout expected for stocks next week

- Indian markets witnessed yet another week of gains with the Sensex rising 1.01% in the last five trading sessions. Continued inflows from the FIIs and buying in large cap companies by index funds contributed to the rise.
- The IIP number at 16.7% for Jan'10 was within market expectation. However, a strongly positive growth for capital goods is likely to cause a sector-specific movement next week.
- Next week, the market players would keenly watch the inflation number as well as the advance tax outgo for the further trigger. Technical experts are sounding a note of caution, though. As the month of March typically sees no fresh commitment from domestic participants, we may not see a major breakout next week.

(h) Oil price settled at \$81.39 per bbl in New York on March 12, 2010

- Crude oil price settled at less than \$82 per barrel on the New York Mercantile Exchange on March 12th after hitting a peak that was last reached two months ago.
- The price of April delivery, light, sweet crude hit a mid-session high above \$83 before settling back to \$81.39 per barrel.
- Oil prices have swung from \$82.75 per barrel in early January to near \$71 in early February and back up again.
- However, many experts feel that oil prices may fall to \$60 per bbl again during the 4th quarter of 2010 as inventories are still high, demand is still relatively weak and there is plenty of spare capacity with the OPEC.

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