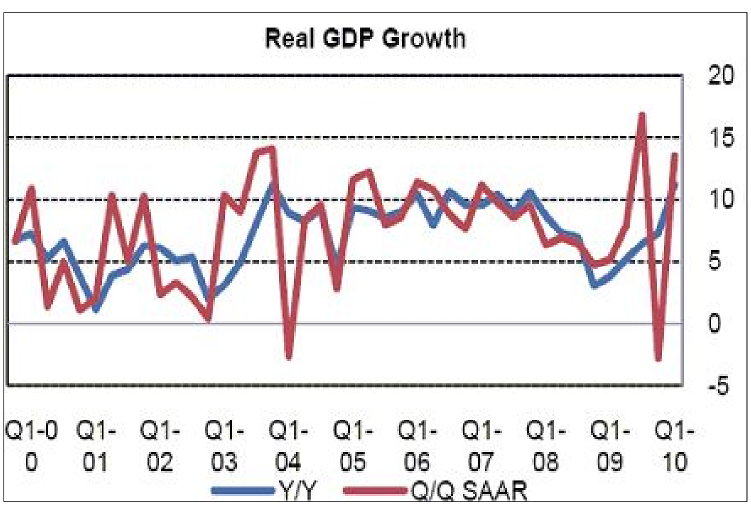
Overview

Despite the severity of the global downturn, and likely subdued growth trajectory of developed economies going forward, we believe that there is a lot to like about India's economic story over the long term. Global economy is seems to be expanding after a recent shock. Indian Economy, however just felt the blow of the global economic recession and the real economic growth have seen a sharp fall followed by the lower exports, capital outflow and corporate restructuring. It is expected that the global economies continue to stay strong in the short-term as the effect of stimulus is still strong and the tax cuts are working. Due to strong position of liquidity in the market, large corporations now have access to capital in corporate credit markets. The table represents comparative growth of the economic indicators :

Economic Indicators				
	04-08 avg.	2009	2010	2011 (expected)
GDP (% growth, real)	8.5	5.7	7.5	7.9
Inflation (%, year-end)	5.8	10.9	10.7	5.7
Fiscal Balance (% of GDP)	-3.9	-7.7	-6.4	-6.1
Exports (% growth)	27	-17.9	16.1	12.1
Imports (% growth)	33.7	-22.1	20	16
Current Account (% of GDP)	-1.1	-0.8	-1	-1.3
Reserves (month of imports)	9.1	9.8	9.4	8.9
External Debt (% of GDP)	17.5	17.4	15.7	14.5
Debt Service ratio	11	9.8	8	7.5
Currency (per USD, year-end)	44.2	46.7	44	41

Market Spotlight

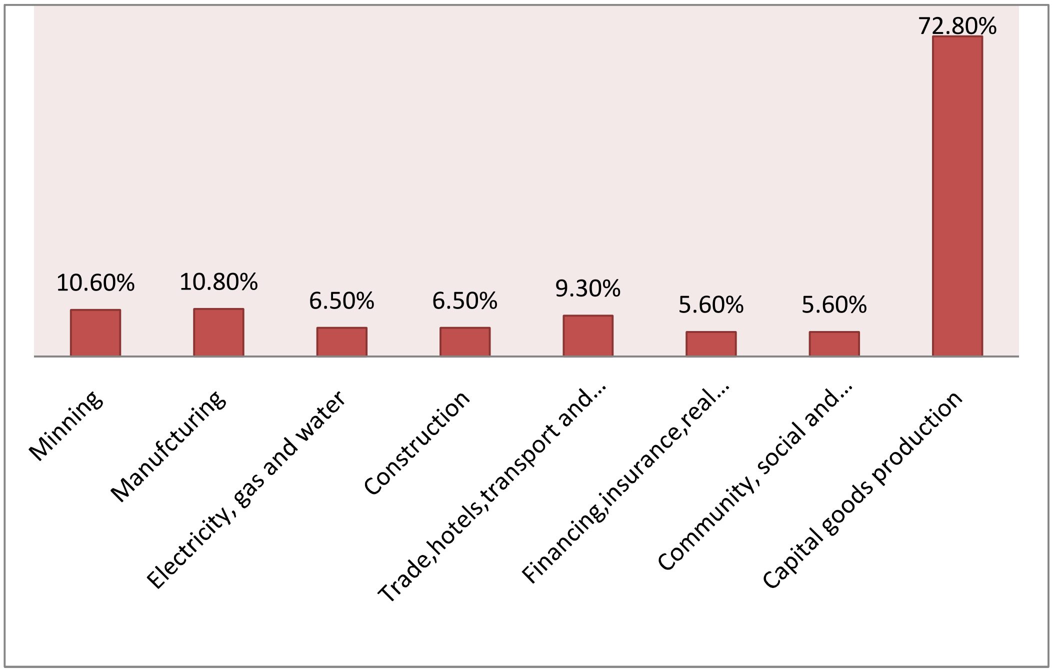
Economic growth surged to 11.2% y/y in Q1 from an upwardly revised 7.3% in Q4, bringing the FY2009-2010 growth rate to 7.4%. Improved monsoon rains and stronger industrial activity supported the increase. The growth is driven by robust performance of the manufacturing sector on the back of government and consumer spending. GDP growth rate of 7.4 per cent in 2009-10 has exceeded the government forecast of 7.2 per cent for the full year. Growth momentum is well entrenched for 2010, but the central bank is scheduling to tighten monetary policy further to contain rising inflation, which is dampening consumer sentiment. All consumer inflation indicators are running near 15% y/y. The central government's budget for 2010-2011 is paving the way for the pullout of fiscal stimulus and fiscal consolidation in the medium long term after the slippage and stimulus of the last 2 years.



Recent Performance

Real GDP growth rose to 11.2% y/y in Q1-10, On a seasonally adjusted basis, real GDP surged 13.5% at an annualized rate. While personal consumption weakened further, to 2.6% y/y, investment activity surged 17.7%, the strongest pace of increase since 2007. On an industry basis, growth was driven by the strongest increase in manufacturing activity on record (+16.3%), and supported by the rapid expansion in the trade, hotel, transport & communications sector. The return of normal monsoon rainfall also resulted in a better performance of the agricultural sector. Industrial activity has shown strong upward momentum recently, clocking in at 17.6% in April, above the 15.1% pace of Q1.

Economic activities which showed significant growth rates in Q1 over the corresponding period last year were :



The Gross National Income is estimated to rise by 7.3 per cent in FY 2009-10 as compared to 6.8 per cent in 2008-09. The per capita income is estimated to grow at 5.6 per cent in 2009-10.

Fiscal Policy

The budget for the 2010-2011 fiscal year projects improvements for the deficit after the Fiscal stimulus of last year and the large one-off expenditures of the year before. As a share of GDP, the deficit is expected to reach 7.8% of GDP (including off-budget food, fuel and fertilizer price subsidies of 1.7% of GDP) from 9.6% last year and 11.8% in 2008/2009. The improvement will come from a combination of weaker expenditure growth from reduced subsidies, and greater revenues from the acceleration of economic growth, the reversal of indirect tax cuts that were part of the fiscal stimulus package, the expansion of the tax base and the revival of the privatization program, as well as the onetime sale of G3 licenses, which generated over USD 15 billion.

Monetary Policy

State of economy:

- The Reserve Bank of India (RBI, the central bank) continued its tightening cycle as inflation pressures are building, by raising reserve requirements and its two main interest rates by 50 basis points since the beginning of the year. While better monsoon rains will reduce food prices, the upward trend in M2 growth suggests that additional inflation pressure is in the pipeline for the second half of this year.

- Money supply (M_3) growth on a year-on-year basis moderated from 16.8 per cent at end-March 2010 to 15.3 per cent as on July 2, 2010 reflecting a slowdown in the growth in bank deposits.

- Year-on-year non-food credit growth accelerated from 17.1 per cent in March 2010 to 22.3 per cent as on July 2, 2010, which was higher than the indicative trajectory of 20 per cent set out in the April 2010 Monetary Policy Statement. This reflects the combined impact of a pick-up in industrial activity and financing of the 3G and broadband wireless access (BWA) spectrum auctions. The increase in bank credit to the commercial sector has also been supplemented by higher flow of funds from other sources. Rough estimates show that the total flow of financial resources from banks, non-banks and external sources to the commercial sector during Q1 of 2010-11 was at Rs.2,50,000 crore as against Rs.61,000 crore during Q1 of 2009-10.

- On the deposit side, banks increased their term deposit rates by 75-100 basis points between March 2010 and July 16, 2010.

- The Base Rates set by major banks are in the range of 7.25-8.0 per cent.

- Money markets remained orderly during Q1 of 2010-11. A significant development was that the Liquidity Adjustment Facility (LAF) window of the Reserve Bank, after remaining in surplus mode for nearly 18 months, switched into deficit mode towards the end of May 2010 and has remained there since. This liquidity pressure was triggered by the increase in government cash balances on account of larger than expected 3G and BWA spectrum auction receipts combined with advance tax payments.

- Consistent with the stance of active liquidity management and in order to prevent a disruption in credit flow, the Reserve Bank took several measures to ease the pressure :
  - First, on May 26, 2010, the Reserve Bank announced additional liquidity support under the LAF to scheduled commercial banks to the extent of up to 0.5 per cent of their net demand and time liabilities (NDTL). A second LAF (SLAF) was also made available on a daily basis. Both these facilities, which were initially available till July 2, 2010, were later extended. While the additional liquidity support facility was extended up to July 16, 2010, the SLAF remains extended up to July 30, 2010.
  - Second, in consultation with the Government, the notified amounts for the issuance of Treasury Bills during June 2010 were reduced by Rs.22,000 crore.
  - Third, during June 16-21, 2010, the Government bought back securities worth Rs.9,614 crore, ahead of schedule.

- There was net injection of liquidity by the Reserve Bank in June and July 2010 (up to July 23). As a result, overnight interest rates, which generally remained around the floor of the LAF corridor up to May, moved up to the ceiling of the corridor in June 2010 and have remained there in July 2010 so far. Similarly, yields on other money market instruments increased, reflecting autonomous tightening of monetary conditions by 150 basis points, equivalent to the prevailing width of the LAF corridor.

- The monthly average yield on the 10-year benchmark government security fell to 7.59 per cent in June 2010 from 8.01 per cent in April 2010 in the expectation that the Government will reduce market borrowing because of higher realizations from spectrum auctions. Subsequently, the yield moved up to 7.73 per cent by the third week of July 2010.

- The foreign exchange market saw volatility increase relative to the previous quarter, with the rupee showing two-way movements in the range of Rs.44.33-Rs.47.57 per US dollar.

- Both the nominal and real effective exchange rates (NEER and REER) have appreciated. While the appreciation in 36-currency NEER/REER at about 1.5 per cent (up to May) was similar, real appreciation on the basis of 6-currency REER was higher at 3.3 per cent as compared with 6-currency NEER appreciation of 1.4 per cent, reflecting higher inflation differentials between India and major advanced economies.

- Of the budgeted net market borrowing of the Central Government for 2010-11 at Rs. 3,45,010 crore, about 38.5 per cent (Rs.1,32,900 crore) of the borrowing was completed by mid-July 2010. As against the budgeted amount of Rs 35,000 crore, the actual realizations under 3G and BWA auctions were about Rs. 1,06,000 crore, resulting in an increase in receipts by over one per cent of GDP.

- During the first two months of 2010-11, both exports and imports continued to expand in contrast to the contraction they showed during the corresponding period of last year. The trade deficit widened during April-May 2010 to US$ 21.7 billion, up from US$ 14.4 billion in the corresponding period of the previous year, reflecting the sustained increase in domestic activity.

On the basis of the current assessment and in line with the policy stance the Reserve Bank announces the following policy measures in June 2010:

Bank Rate: The Bank Rate has been retained at 6.0 per cent.

Repo Rate: It has been decided to:

- Increase the repo rate under the Liquidity Adjustment Facility (LAF) by 25 basis points from 5.5 per cent to 5.75 per cent with immediate effect.

Reverse Repo Rate: It has been decided to:

- Increase the reverse repo rate under the LAF by 50 basis points from 4.0 per cent to 4.50 per cent with immediate effect.

Cash Reserve Ratio: The cash reserve ratio (CRR) of scheduled banks has been retained at 6.0 per cent of their net demand and time liabilities (NDTL).

Expected Outcomes: Monetary policy actions are expected to:

a. Moderate inflation by reining in demand pressures and inflationary expectations.

b. Maintain financial conditions conducive to sustaining growth.
c. Generate liquidity conditions consistent with more effective transmission of policy actions.
d. Reduce the volatility of short-term rates in a narrower corridor.

Financial Market

Risks to the global financial system increased in Q2 of 2010 in the wake of market concerns about fiscal sustainability in the Euro area and possible spillover to other parts of the world. Domestic financial markets functioned normally during Q1 of 2010-11 though there was some spillover from global volatility. While call money rates edged up due to tight liquidity conditions created by higher revenue inflows to the government, medium to long-term bond yields moderated because of expectations of lower fiscal deficit. Exchange rate of the Indian rupee exhibited some depreciation and equity prices remained mostly subdued, reflecting the impact of the global market trends and FII flows.

Domestic Financial Market

The concerns in domestic financial markets shifted from the large fiscal deficit and rising inflation in 2009-10 to escalated uncertainties in the global markets and the associated risks to global recovery in Q1of 2010-11. Nevertheless, several segments of financial markets witnessed further recovery in trading volumes in Q1 of 2010-11, although marked by some increase in price volatility. Except for some increase in spread/volatility in certain segments, overall financial market conditions remained stable.

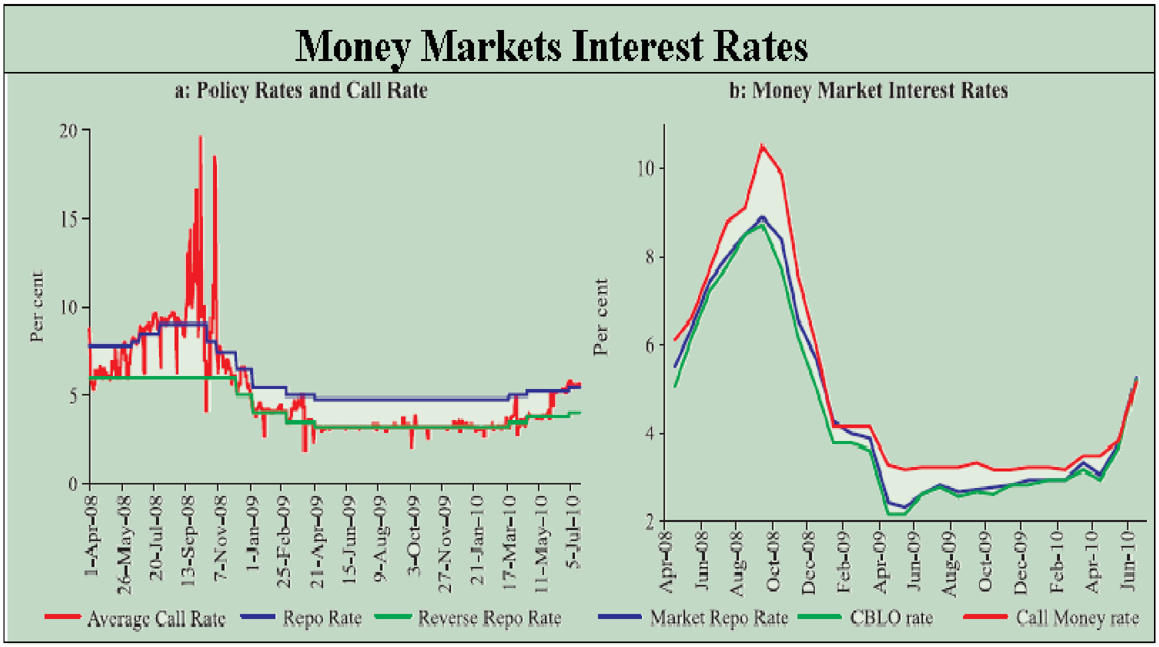
Domestic Financial Market At a Glance

Year/Month	Call Money		Govt. Securities Market		Foreign Exchange Market			Liquidity Management		Stock Markets			
	Daily Turnover (Rs. crore)	Call Rates* (Per cent)	Daily Turnover^ (Rs. Crore)	10-Year Yield@ (Per cent)	Daily Inter-bank Turnover (US$ mn)	Exchange rate@ (Rs./ US$)	RBI's net FC purchase (+)/ sale (-)	MSS Out-standing# (Rs. crore)	Average Daily LAF (Rs. crore)	Daily BSE Turnover (Rs. crore)	Daily NSE Turnover (Rs. crore)	BSE Sensex**	CNX Nifty**
1	2	3	4	5	6	7	8	9	10	11	12	13	14
2008-09	**22,436**	**7.06**	**10,879**	**7.54**	**34,812**	**45.92**	**-34,922†**	**1,48,889**	**2,885**	**4,498**	**11,325**	**12303**	**3713**
2009-10	**15,924**	**3.24**	**14,426**	**7.23**	**30,107**	**44.95**	**-2,635†**	**23,914**	**1,00,015**	**5,651**	**16,959**	**15585**	**4658**
Apr-09	21,820	3.28	15,997	6.55	27,796	50.06	-2,487	75,146	1,01,561	5,232	15,688	10911	3360
May-09	19,037	3.17	14,585	6.41	32,227	48.53	-1,437	45,955	1,25,728	6,427	19,128	13046	3958
Jun-09	17,921	3.21	14,575	6.83	32,431	47.77	1,044	27,140	1,23,400	7,236	21,928	14782	4436
Jul-09	14,394	3.21	17,739	7.01	30,638	48.48	-55	22,159	1,30,891	6,043	18,528	14635	4343
Aug-09	15,137	3.22	9,699	7.18	27,306	48.34	181	19,804	1,28,275	5,825	17,379	14415	4571
Sep-09	16,118	3.31	16,988	7.25	27,824	48.44	80	18,773	1,21,083	6,211	18,253	16338	4859
Oct-09	15,776	3.17	12,567	7.33	28,402	46.72	75	18,773	1,01,675	5,700	18,148	16826	4994
Nov-09	13,516	3.19	17,281	7.33	27,599	46.57	-36	18,773	1,01,719	5,257	16,224	16684	4954
Dec-09	13,302	3.24	14,110	7.57	27,439	46.63	0	18,773	68,522	4,671	13,948	17090	5100
Jan-10	12,822	3.23	12,614	7.62	32,833	45.96	0	9,944	81,027	6,162	17,813	17260	5156
Feb-10	13,618	3.17	12,535	7.79	34,040	46.33	0	7,737	78,661	4,125	12,257	16184	4840
Mar-10	17,624	3.51	8,544	7.94	32,755	45.50	0	3,987	37,640	4,751	13,631	17303	5178
Apr-10	16,374	3.49	14,242	8.01	36,242 P	44.50	0	2,737	57,150	4,696	13,828	19679	5295
May-10	16,786	3.83	24,225	7.56	39,997 P	45.81	0	922	32,798	3,940	12,937	16845	5053
Jun-10	14,258	5.16	21,300	7.59	36,216 P	46.57	..	317	-47,347	4,204	13,005	17300	5188

* : Average of daily weighted call money borrowing rates. ^: Average of daily outright turnover in Central Government dated securities.
@ : Average of closing rates. #: Average of weekly outstanding MSS. **: Average of daily closing indices. †: Cumulative for the financial year.
LAF : Liquidity Adjustment Facility. MSS: Market Stabilisation Scheme. BSE: Bombay Stock Exchange Limited.
NSE : National Stock Exchange of India Limited. P: Provisional. .. : Not available.
Note: In column 10, (-) indicates injection of liquidity, while (+) indicates absorption of liquidity.

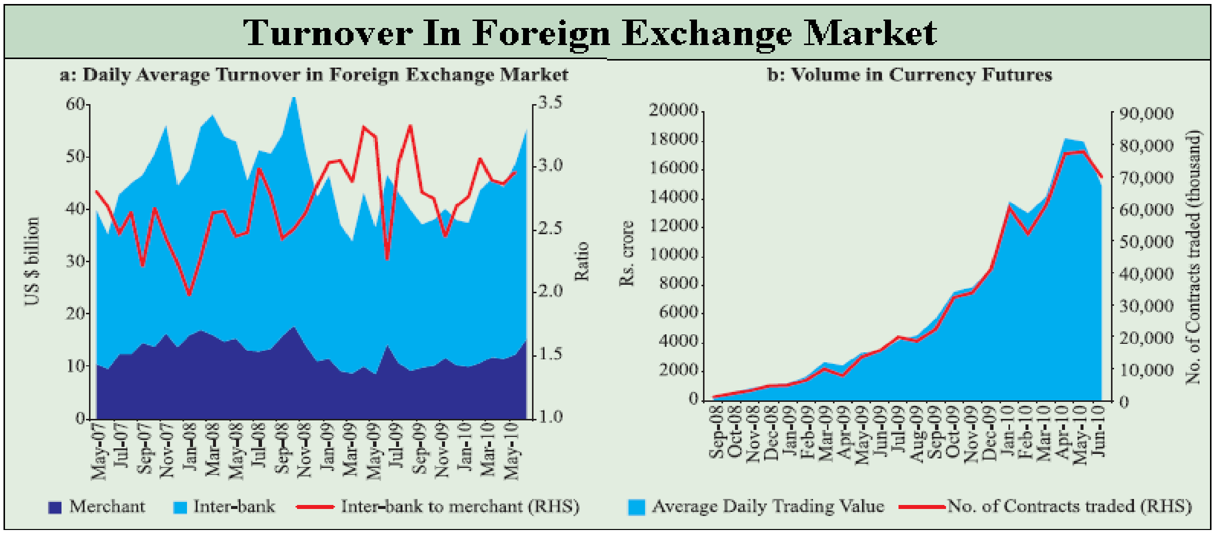
Money Market

LAF window turned from reverse repo to repo mode. In order to address the liquidity pressures, additional liquidity support was provided to scheduled commercial banks under the LAF to the extent of 0.5 per cent of their net demand and time liabilities (NDTL). The Reserve Bank also conducted second LAF on a daily basis. These measures helped overcome liquidity stress in money markets and contain volatility in call rates.



Foreign Exchange Market

The Indian rupee exhibited greater two-way movement against the US dollar during Q1 of 2010-11. The rupee strengthened against the US dollar in April 2010 on the back of capital inflows and positive growth outlook. Subsequently, with the signs of the euro area debt crisis spreading further and the US dollar strengthening against most currencies, and withdrawal of funds by the FIIs, the rupee came under depreciation pressure. The exchange rates in the non-deliverable forward market (NDF), the currency future market and the spot market have exhibited similar pattern. Increased volatility in the foreign exchange market resulted alongside increase in turnover in the spot, forward and futures markets. The rupee-dollar futures continued to dominate the currency futures segments in the exchanges, accounting for about 90 per cent of the total notional values. The higher trading volumes, particularly in the futures market, have coincided with the increased volatility in the spot exchange rate.



External Sector

Strong domestic demand and higher energy prices are again putting pressure on the trade deficit, which totalled USD 27.1bn in Q1-10. While exports are rebounding, up 36% y/y in April, in parts due to weak base effects, imports are rising are rising at a much faster pace, up 43% y/y. However, the trade deficit is supported by strong transfers from abroad, renewed foreign investment inflows, as well as the return of external demand for India's software services, to a record amount in Q4. Nonetheless, foreign exchange reserves continue to slowly decline since October 2009, falling to USD 261bn at the end of February, which still represent over 8 months of current account debit cover.

- The number of registered foreign institutional investors (FIIs) was 1710 as on May 31, 2010 and th inflow in equity during January to May 2010 was US$ 4606.50 million while it was US$ 5931.80 debt.
- Net investment made by FIIs in equity between June 1, 2010 and June 14, 2010 was US$ 530.05 mil it was US$ 875.73 million in debt.
- As on June 4, 2010, India's foreign exchange reserves totalled US$ 271.09 billion, an increase of billion over the same period last year, according to the Reserve Bank of India's (RBI) Weekly Supplement.
- Moreover, India received foreign direct investment (FDI) worth US$ 25,888 million during Ap 2009-10, taking the cumulative amount of FDI inflows during August 1991 - March 2010 to US$ million, according to the Department of Industrial Policy and Promotion (DIPP).

The services sector comprising financial and non-financial services attracted 21 per cent of the total FDI equity inflow into India, with FDI worth US$ 4,392 million during April-March 2009-10, while construction activities including roadways and highways attracted second largest amount of FDI worth US$ 2,868 million during the same period. Housing and real estate was the third highest sector attracting FDI worth US$ 2,844 million followed by telecommunications which garnered US$ 2,554 million during the financial year 2009-10.

- Exports from India were worth US$ 16,887 million in April 2010, 36.2 per cent higher than the level in April 2009, which touched US$ 12,397 million, according to the Ministry of Commerce and Industry. India's imports during April 2010 were valued at US$ 27,307 million representing a growth of 43.3 per cent over April 2009.

- India's logistics sector is witnessing increased activity—the country's major ports handled 560,968 metric tones (MT) of cargo during April-March 2009-10, an increase of 5.74 per cent over previous year traffic, according to revised estimates released by the Ministry of Shipping.
- Foreign tourist arrivals in India during the month of May 2010 were 345,000, an increase of 15.5 per cent over May 2009. Foreign tourist arrivals during January-May 2010 were 2.263 million, an increase of 11.3 per cent over the corresponding period last year. Foreign exchange earnings during May 2010 were US$ 951 million, an increase of 42.2 per cent over May 2009. Foreign exchange earnings during January-May 2010 were US$ 5822 million, an increase of 38.3 per cent over the corresponding period last year, according to data released by the Ministry of Tourism.

Industry Statistics

- The total telephone subscriber base in the country reached 971.69 million in June 2010, taking the overall tele-density to 56.83, according to the figures released by the Telecom Regulatory Authority of India (TRAI). Also the wireless subscriber base increased to 653.51 million.
- According to the latest statistics from the Association of Mutual Funds in India (AMFI), the assets under management (AUM) of mutual funds were worth US$ 170.46 billion in May 2010 as compared to US$ 135.58 billion in May 2009.
- As per NASSCOM's Strategic Review 2010, the BPO sector continues to be the fastest growing segment of the industry and is expected to reach US$ 12.4 billion in 2009-10, growing at 6 per cent.
- According to data released by Society of Indian Automobile Manufacturers (SIAM), the total number of vehicles including passenger cars, commercial vehicles, two wheelers and three wheelers produced in 2009-10 was 14,049,830, as compared to 11,172,275 produced in 2008-09.
- According to the Gem and Jewellery Export Promotion Council, the exports of gems and jewellery from India including rough diamonds, rose by 57.08 per cent during April-May 2010 to touch US$ 5551.24 million.
- According to the Ministry of Civil Aviation, domestic airlines carried 211,380 passengers between January-May 2010, an increase of 21.95 per cent over 173,340 passengers carried in the same period last year.
- The number of corporate merger & acquisitions (M&As) and private equity (PE) transactions, have more than doubled during January-May 2010. 439 M&A and PE deals valuing over US$ 30 billion took place between January-May 2010 as compared to 179 deals worth US$ 8.1 billion in the corresponding period in 2009.
- The HSBC Market Business Activity Index, which measures business activity among Indian services companies, based on a survey of 400 firms, rose to 62.1 in April 2010, its highest since July 2008, and compared with 58.1 in March 2010.

Outlook

Despite the uncertain outlook for developed economies, further monetary tightening in the pipeline and the beginning of pullout of fiscal stimulus, real GDP growth in India will accelerate this year and next, reaching 7.5% this year and 7.9% in 2011. Investment and industrial activity, which is more oriented towards the domestic market, will sustain growth, while consumer sentiment will be dampened by high inflation. The election victory of the Congress Party bodes well for continued economic reforms, with the move towards gradual liberalization and deregulation expected to continue under the current government. While sustained annual double-digits growth remains a few years away, a return to the 8-9% growth rates seen before the crisis is very likely.

- The data centre services market in the country is forecast to grow at a compound annual growth rate (CAGR) of 22.7 per cent between 2009 and 2011, to touch close to US$ 2.2 billion by the end of 2011, according to research firm IDC India's report published in March 2010. The report further stated that the overall India data centre services market in 2009 was estimated at US$ 1.39 billion.
- According to a report by research and advisory firm Gartner published in March 2010, the domestic BPO market is expected to grow at 25 per cent in 2010 to touch US$ 1.2 billion by 2011. Further, the BPO market in India is estimated to grow 19 per cent through 2013 and grow to US$ 1.8 billion by 2013. According to the report, the domestic India BPO services market grew by 7.3 per cent year-on-year in 2009.
- The BMI India Retail Report Quarter 3, 2010 released in May 2010, forecasts that total retail sales will grow from US$ 353.0 billion in 2010 to US$ 543.2 billion by 2014.
- According to a report titled 'India 2020: Seeing, Beyond', published by domestic broking major, Edelweiss Capital in March 2010, stated that India's GDP is set to quadruple over the next ten years and the country is likely to become an over US$ 4 trillion economy by 2020.
- India will overtake China to become the world's fastest growing economy by 2018, according to the Economist Intelligence Unit (EIU), the research arm of London-based Economist magazine.

Exchange rate used: 1 USD = 47.14 INR (as on June 2010)

Sources: EIU, Economic Survey, Indian economy stats, World Bank, International Monetary Fund, RBI, IBEF

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