

ANALYTIQUE



Vol. VIII · No. 2 · Apr - Jun 2012

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Bombay Chamber of Commerce & Industry

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The Chamber can boast not only of its longevity but also of its impeccable lineage. With more than 4000 prime companies as its members, the Chamber represents the cream of Indian Industry, Commerce and Services. While the name 'Bombay Chamber' conjures images of an organization representing exclusively a city-based membership, in reality it represents a wide spectrum of highly reputed and professionally run companies which are based in the city of Mumbai, but whose manufacturing facilities and commercial influence spread not only all over India but also internationally.

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From the Editor's Desk

There is little doubt that the growth outlook in 2012-13 will be lower than anticipated.

As we know several official statements assert the fact that global macro economic conditions have deteriorated. Among the BRICS countries, growth in China fell from 8.1 per cent in Q1 of 2012 to 7.6 per cent in Q2. Growth also moderated significantly in Brazil and South Africa in Q1. According to the Report published by IMF, growth in a number of major EDEs turned out to be lower than forecast by it earlier.

On the domestic front, the macroeconomic situation continues to raise concerns. While growth has slowed down significantly, inflation remains well above the comfort zone. Among the EDEs with large current account deficits, the depreciation of the Indian rupee was relatively large, reflecting moderation in capital inflows in India. In such a situation current account deficit (CAD) and fiscal deficit pose significant risks to national macroeconomic stability.

Yet some experts do believe that a recovery, even if modest, still possible if appropriate policy correctives are quickly put in place. They cited example that credit expansion in Q1 of 2012-13 has picked-up and PMIs for manufacturing and services remain in expansion mode. Thus, while growth has decelerated, a sharp dip can still be averted by removing constraints on FDI and improving the investment climate by moving quickly to address bottlenecks in infrastructure along with structural improvements, fiscal consolidation to improve business environment which in turn will stimulate growth in the near future.

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Printed at Uchitha Graphic Printers Pvt. Ltd.

On the Managing Global Turbulence: An SME Perspective

Ajit Chaube*

All SMEs grow up facing turbulences before the SME is commissioned. SMEs mostly are borne out of core knowhow of manufacturing and have compact management structure. Help in global business management skills is wanting. Identifying customers and completing cycle upto secured repeat business is a challenge.

In this back drop the SME needs to succeed in international business. The struggle and success has to become story and history.

SMEs are adventurous by nature. Risk taking and facing consequences gets to be the routine. This is all the more true in case of SSI SMEs who are mostly started by first generation technocrat entrepreneurs. After learning to swim in the domestic markets, it is natural that the urge to taste the global waters catches on. This urge to be in global space brings in, with it, the inner management schooling to face the turbulence.

SMEs learn most of the things while doing it, on the job. The cost is also borne while learning on the job. Sometimes this gets tough to handle and sometimes it is pleasant.

The effort is of sharing experiences. This may turn out to be limited is it based on a singular case and may be limited to that extent.

This limited global exposure is the first and most important challenge in foreseeing and managing the global business. The expertise needed is external to the core

skills of SME. The development of international business model and vision are in the nascent stage.

One thing though is always clear. That is to build the business in a sustainable manner for a long run.

To start with SME has to identify suitable markets. This, while being focused on selecting open, friendly and responding customers in a short lead time. This approach does need basic information. The initial quicker responses, result in cost saving and the much needed stimulus for the SME. Having a sound application exposure and quality product are the prime technical inputs. The cost of initiating and establishing contact is a matter of concern till the business is initiated.

Thus, once the product is accepted on technical fronts the real mechanism of getting into the commercial part starts. The initial acceptance for the product is always on the basis of meeting the needs of your global customer, as is applicable everywhere. Pricing, leading to the landed cost is of foremost importance amongst few others to start the business.

For the SME the offering of price is the starting step and though the price is the starting step, the pricing mechanism has to be workable on an acceptable basis yet in a sustainable manner, in the long run, is critical.

This is where the exposure, experience and foresight in analysing the economic scene comes in.

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Following are the broad factors that influence this.

First, the economic stability of the country and the region in general and the credibility of the customer in particular.

Second, the currency volatility or stability of the customer country and our own country. Both have direct bearing on today's business and the business to do in the future.

Third, in business based on crude oil fractions, the fluctuations in international crude oil prices matter a lot. Though the overall quantum of the SME business is very small in relation to the effect of international crude oil volatility the sentiments bear strongly in the minds of decision makers.

These factors loom over when getting into the international business.

The facilitating factors at the business initiation stage is however only one. It is quick response by client and his need. If the SME is there at the right time, the platform for a successful business initiation gets built. This has to be followed by the product quality and spot on. Also, documentation to built in a reasonable period. The gains are formidable in establishing as a reliable international source.

The tide turns when a plethora of international factors influence the business. Adverse factors make things tougher. The scene turns otherwise. Fresh areas of concern chip in. Lowering of consumption in the customer country and region has worst effect. The economy of the region starts posing challenge. The SME starts understanding the effect

of economic turbulence on its global business. Managing this becomes a task.

A challenge created by external factors outside our immediate grasp. But a challenge which can be faced with controlled planning and contained with internal plan. Again, a strong domestic presence becomes pillar of strength. Limited dependence on international business helps at such times.

The pliability of being an SME, with controllable cost and limited lost volumes, comes in handy.

It is important to continue being there in the international business:

It is advisable not to take a break from the market and to have business continuity with the customer work on reduced volumes to achieve this the SME needs to plan to enter into short term commitments to do business on peace meal basis even if business dries up.

The economic turbulence can be faced by the SME by committing to peace meal and stand alone orders than bulk large ones and over a longer period.

This is to select credit worthy potential customers even at marginal bottom lines while looking forward to the turn around.

The approach ensures that the SME does not loose contact with the market and the customer and also that the risks are less as volumes committed are within control.

And within India, the SME practices covering the exchange under forward contract covers, eliminating surprises. This results in firm pre-measured returns. A safer route is always based on realities and not on chances.



Sustainable Double Digit Growth: Challenges & Opportunities

Everybody here is optimistic about double-digit growth. And I am a person who likes moderation.

Whenever we talk of economic situation, we should not ignore the immediate preceding history in the economy. It was said that today planning process is diluted and Planning Commission does not enjoy the powers it used to few years back. Still planning process continues. If

we look at the report of the Eleventh Planning Commission, it gives an interesting table of growth rates of Indian economy

right from the First Plan to now. If we observe the figures pertaining to the Tenth Plan, there the growth rate has been modest. Even during the Eleventh Plan, three years in succession, we had growth rate of about 9 per cent. During the Financial Crisis in 2008-09, the world had shaken totally and only two bright spots were observed on the global financial maps – China and India. So we are feeling far happier than what we did earlier. Maybe that is why Bombay Chamber thought of arranging a conference named “Double Digit Growth: Challenges & Opportunities.”

In Remembrance :
Dr. R. H. PATIL
1938 – 2012*

Can we have ten per cent or more growth rate? This is not something unusual. Historically, there are countries like Japan, China or the East Asian Countries which have observed double digit growth for about decades. When we talk about economic growth rate, it is not purely to do with Economics. It is something to do more about human beings. In the sense, how national psyche is made up of. Is it growth oriented or has some different value system? In our context, India as a nation is far more complex than China if not with respect

to population. Too many different views and too many varied ideologies. Now-a-days, financial newspapers do not actually carry what nation as a whole feels. It reflects only elite ideologies in few cities or what few elite people say. This is the real problem.

Whenever we talk of double digit growth, we should also look at huge masses of people below poverty line. This component is as much as 30 per cent of the total population. No estimate puts a figure below 300 million. This is far more than the total population of the United States or many countries put together in Europe. So when we talk about double

* This talk was delivered at Conference on “Sustainable Double Digit Growth – Challenges & Opportunities” organized by Bombay Chamber of Commerce & Industry on April 12, 2010 by Dr. R.H. Patil.

digit growth, are we doing something for this section of the society? No discussion on double digit growth makes any reference to this component or components of growth when we talk about different segments of the Indian economy. All this become more relevant in the recent experience of food inflation prevailing over 17 per cent. This kind of an incident used to become a matter of unrest in the society. I hardly find discussion or debates in the newspapers that there is something to worry about.

Another interesting part is for quite many years, Agriculture has missed growth and this is not being highlighted. We still talk a lot about our Green Revolution days and forgot that it happened many decades ago and even today sixty per cent of the population is non-urban. This section is dependent on agriculture indirectly if not always directly. This huge wage earning segment in the non-land owning section is also at the mercy of what happens in the rest of the economy. If we just have a look at last three Plans, Eight, Nine and Ten Five Year Plans, what has been happening with the Government Expenditure? It is continuously declining. It has become almost half of what it used to be in the Eight Plan. Eleven Plan is also having the consolation that the government expenditure should not fall below the existing level of 20 per cent. It means 80 per cent investment is happening in non-government or private sector. There is a universal recognition that there is something basically wrong with our infrastructure. Huge amount

of investments are required and quite a lot of segments of infrastructure are such where only government can invest. And, the government doesn't have money. This was the problem thirty years ago as well. Even today when the government attempts to reduce the budgeted fiscal deficit, the first cut comes on the capital expenditure. The revenue expenditure in the recent period has become a serious issue. On one side no efforts are being made to reduce the revenue expenditure and on the contrary, it is getting out of control. I do not observe any worry in the government. With due respect to the Government and Prof. Kaushik Basu, I just wish to inform the government about what other people feel about the situation.

Given all these obstacles, how are we going to achieve the double digit growth? We are also missing on one more aspect. We observed Nine per cent growth in last couple of years. What were the components of this growth? It has been emphasized in the Economic Survey that the service sector which accounts for almost 53 per cent of GDP is growing. It is this sector which has led the growth many years. We as the student of Economics learn that the service sector responds to growth in the developed countries but in the developing economies like India it responds to growth in the rest of the economy and it grows to serve the rest of the economy. In India, the service sector is growing for two reasons – there is huge component of growth in the form of salary increases although we are not able to measure the

productivity. This is mainly happening in the public sector. This has spread to even para government sector due to Sixth Pay Commission. This is obviously not true for competitive sector where salaries are decided by the individual administrators. This has generated genuine income – especially in IT and IT enabled services which has been grown very rapidly in last 10 years. So if the service sector is leading it is because of these two industries. These two sectors have created a large employment opportunities for qualified and highly skilled workforce and has contributed to the forex reserves of India. Yet, the employment intensity is not growing in the same sectors. This is mainly because the administrative expenditure is on rise and there is constraint on the recruitment of fresh people. In the IT, highly skilled per capita value addition is high and so the employment need not grow and still generating high amount of income.

Other observation is that in India, growth is not getting spread to masses. There is no considerable growth in employment. Secondly, there was no mention in the planned documents about a sector which has consistently contributed to the growth and that is development banks. Major industrial ventures in the country were funded by the development banks. They created the growth impulses for the rest of the economy in mid-90s. This was because there was a structural funding arrangement for these developmental banks which was later dismantled by the Govt. of India. In those days, the government used to

say that in India there was a trading mentality, so they should encourage the long-term investments. The banks should lend money at the interest rate lower than the rate for working capital loan for long term investments. Development banks used to lend their rates well below rates that bank used to charge. This was how the long term investments were created and they require funding so special arrangements in the budget. Budgetary support only came as a fraction by way of equity. But all that has been dismantled and those institutions are vanished. IDBI has become IDBI bank, ICICI turned into ICICI bank, IFCI is totally in doldrums; still there is no concern in the government. What had they created out of this? They created a new set of institutions. HUDCO for financing the urban development and in power financing, we have RFC and the PFC which are getting a much higher support that the term lending institutions got. The term lending institutions got a commercial support and there was no subsidiary involved. PFC and RFC are funding power projects and if we look at their balance sheets, rating agencies call them as AAA entities. I being the finance guy, look at the quality of assets these companies are holding. I observe there are junk assets. They have assets of entities which are loss-making. So the government has actually demolished commercially efficient organizations and created institutions whose borrowings should be clubbed into government deficits. Today, if we add budgetary deficit to quasi deficit, it is

in excess of twelve per cent as you had in 1990 when we had a major financial crisis. This puts a question – is it right to talk of Ten per cent growth rate?

Another straw in the wind is exchange rate is appreciating very fast. Almost 20 per cent in last twelve months. The Current Account Deficit (CAD) is almost about 3.5 per cent. If we exclude the remittances of the Indians, then the CAD will go to 6-7 per cent. Today, FIIs are overlooking these factors, but, if these things repeat quarter after quarter they will relook and run back. Our trade deficit is 10 per cent of GDP and oil prices are bound to increase further. I suppose as the global economy revives, the oil prices will go above USD 120. With this, the cost of imports will go on and consequently the trade deficit will widen. If trade deficit go up to 15 per cent of GDP, do you think the FII money would remain in the country? These are all disturbing signs.

As a student of Economics, I used to talk about Havargler Curve. With exchange rate fluctuations, export oriented and import substituting industries get affected in different ways. Large section of industry will get affected due to appreciating exchange rate. If we just want financial sector to grow, keeping the other sections underdeveloped, then we ignore these issues and need not talk of 10 per cent growth.

Why 10 per cent growth looks to be a distant dream for me? Look at our model of growth. Western countries like UK, USA, Germany, etc. have

industrialized over two centuries. Do we want that much time span to grow? Or something like East-Asian countries have done? We want to shorten the process of growth. The countries which have grown rapidly, had given emphasis on two sectors – industry and infrastructure. On the contrary, in Indian growth model, these two sectors have been constantly ignored. In the last ten years, the industry has not grown. The employment intensity of the organized industry has declined. There are many infrastructure projects where the government needs to finance but does not have money. The government is not seen of attracting private capital as well.

Every industry needs power supply. If we read Economic Survey of India, in last fifteen years, the power shortage continues to be at its levels in spite of all the efforts made by the government. The loss of power while transmission across the country is 40 per cent of the total power generated. In the Tenth Plan, the target for creating the additional capacity of power was 41,000 Mw and what was realized was 21, 000 Mw and what ultimately went into production was merely 18,000 Mw. The installed capacity today is 156 GW and the government wants to add a capacity of 79 GW in the Eleventh Plan. But according to industry analysis, the possible addition will be 45 to 50 GW. About 65 per cent of thermal capacity is coal-based and were 76 per cent of planned capacity is thermal. The coal imports were 50 million tons in the year 2009. We expect 70 million tons in 2010 and 100

million tons in 2013. Can Indian ports handle this large quantity of coal? If they cannot, there would be shortage. On the other side, the government is thinking seriously to denationalize the coal. Coal India will have its own limitations to produce coal owing to capital constraints. Is power shortage going to get resolved soon? Other case is of construction of National Highways which has created huge employment in the country. How many thousand miles we are adding every year? The figure is too small.

So just because in a single year, the monsoon is bountiful, agriculture production goes up, national income growth rate is satisfactory, we can achieve double digit growth? For the growth to sustain, the investment should orient to these two sectors – industry and infrastructure. Student of Economics learn that investments generate additional investments; one through the multiplier effect and another accelerator effect and these two are equally strong, when industrial infrastructure grows. We cannot sustain the growth depending on the service sector. This is because, for example, IT sector grew just because the rest of the world is growing. When the rest of the world face doldrums, will our IT sector continue to maintain the GDP numbers? IT growth can never be the solution for the broad-based growth. We cannot bring people below poverty

line to respectable human living standards with IT growth.

On the financial sector, there is a simple mantra suggested by various committee reports. That is just open the flood gates for foreign investors to enter. I doubt, do we have a low esteem for foreign investors? If our fiscal deficit continues to grow, how long can we attract FIIs in government securities? The last year, borrowings funded 40 per cent of the government expenditure in India. This year the figure could be marginally low. I think, next six months would be crucial. It would decide how much FII inflows sustain with mounting PEE levels. After certain level, the development in the real economy would affect the FII bubble. The current account deficit would worsen and as observed globally, a healthy state of economy is where current account deficit is not more than two percent. In case India's CAD rises to 4 per cent from its present state at 0.5 per cent, it's a question how much of foreign exchange reserves would remain within the country. While Rupee is appreciating and stock markets are booming, something is a mess.

The government should take up the necessary measures before situation becomes worse to handle. There are the signs of worry than cheer. I hope this reality check will moderate the Eutopia.



Glitter of Gold

Aditi Kasbekar*

Abstract

The whole of the financial system today is sitting on piles of toxic paper; Bonds and Currencies; that we proudly call "Assets" in the modern world of fiat currencies. The paper argues as this human mind gets accustomed to the illusion created by the most trusted medium of exchange, people invariably tend to forget that the currencies are in effect, not the assets but liabilities; massive liabilities of the central banks around the globe.

Introduction

As the world drowns itself in the swarm of debt, ironically to clean up the mess originally created by debt, one asset has continued to shine bright and post impressive returns. Gold has climbed from about \$250 a decade back to well above \$1750.

But with the year end sell-off in gold where the price gave up half of its yearly gains in less than a month's time, many questions were raised as to whether the 11 years of bull market in Gold has finally come to an end. Before we jump to any conclusion, let us consider some of the reasons for the 2011 year-end sell-off:

First, concerns over the EU crisis led to weakening of the Euro against

the Dollar. Gold, which is primarily denominated in USD, was worth fewer dollars as the dollar appreciated.

Second, EU crisis led to fears of decrease in demand for jewelry as discretionary consumption is cut back. Jewelry being the main source of gold demand resulted in falling gold prices.

Third, gold was one of the very few assets that made money in 2011. As the year ended many investors targeted gold to take profits.

The Analysis

If we look at the above reasons, they seem relatively temporary and not powerful enough to dethrone gold.

However, there are many notable investors who do not believe in the power of gold. Let us now analyze some of the Anti- gold remarks.

First, economist Nouriel Roubini, professor at Stern School of Business, New York University had called gold to be a "Bubble" way back in 2009 when the price of gold was \$1100. He even went on to say "I don't believe in Gold."

Gold has given impressive returns ever since and touched its all-time high of \$1900 in 2011.

Second, reputed fund managers like George Soros and John Paulson

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recently cut their gold positions. Savvy investors like Warren Buffet have shunned gold for years, saying “it earns nothing.”

But James Grant, the founder of Grant’s Interest Rate Observer, whose musings on the market have been appreciated by the cognoscenti of the Wall Street for over 30 years, says,

“It is the nature of Gold that its valuation must forever be a mystery. It earns nothing; it pays no dividend, no conference call, no management to call up and complain to. What I do think is Gold is simply a reciprocal of world’s faith in the institution of managed currencies. It is one divided by T, where T stands for trust and trust is a shrinking number and will continue to shrink. Therefore, I am still bullish on Gold.”¹

These comments by Mr. Grant came at a time when gold was trading at \$1800 plus levels.

Third, the anti-gold people refuse to see gold as a currency. One of the many reasons they put forward is, there is not enough gold to call it a currency.

For them, James Rickards, the author of the international bestseller ‘Currency Wars’ offers an apt explanation. He says,

“There is always enough gold; it is always a question of price. There is not enough gold at \$1700 an ounce but there is plenty of gold at \$7000 an ounce. The point is not about the quantity of gold; it’s about the price you choose to back up the money supply.”

Gold was, is and will always remain the ultimate currency. Gold is not a fiat currency; it is no central bank’s liability. It is a currency that neither ECB nor the Fed can decide to print more of.

To understand some of the fundamental reasons why gold should continue to appreciate we need to think of the world in the gold space, as advised by Mr. Rickards. Thinking of the world in gold space means studying who has the gold, who needs the gold and from where does it come from.

As per the latest figures of the World Gold Council, the largest holders of the gold reserves are

Country	Tonnes of Gold	% of the foreign reserves
United States	8133.50	76.6%
Germany	3396.30	73.7%

Source: The World Gold Council

Euro area (including ECB) holds about 10788 tonnes of gold.

In spite of this high percentage of gold holdings in the western world, reckless money printing has led to all time high ratio of paper currency to gold. Total financial paper in the world excluding real estate is about \$200 trillion. Bullion market in terms of gold is just about \$3 trillion.² This disparity makes gold very valuable.

According to World Gold Council data, China holds 1054.1 tonnes of gold which is a mere 1.8% of their foreign exchange reserves. India holds 557.7 tonnes which is only about 9.6% of our foreign reserves. In 1970s, gold accounted for 20% to 25% of

our reserves. But post-liberalization, inflow of foreign funds in the economy without corresponding addition to physical gold stock resulted in gold reaching less than 4% of our reserves in 2007-2008.³ RBI purchased 200 tonnes of gold from IMF in 2009 in order to strengthen our position and diversify our forex reserves in the wake of excessive money printing by International Central Banks. As this realization dawns upon other central bankers around the world, the demand for gold will shoot up.

After the credit crisis of 2008, the governments around the world have amassed massive proportions of debt to save the institutions deemed 'Too Big to Fail'. In the last nine years, total credit market debt has gone up from \$80 trillion to \$210 trillion growing at 12.5% per year.⁴

There are only four ways out of the debt problem:

- Grow out of debt with higher productivity and higher exports:

This is not happening as the worldwide demand is growing at snail's pace.

- Strict Austerity Measures:

This threatens increasing unemployment and decrease in GDP leading to further worsening of the deficit problem.

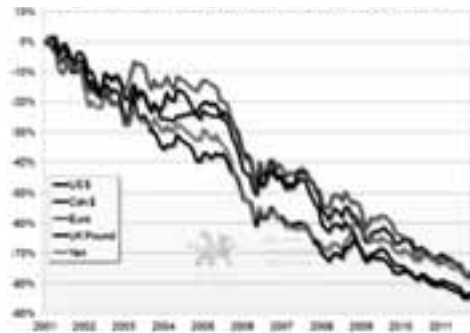
- Default on the debt obligations or Haircuts:

This could make further issuances of debt difficult.

- Print more and more money:

Opening up the central bank's printing presses postpones the inevitable and the politicians have conveniently selected this option. But this leads to decrease in purchasing power of money and hence increase in price of Gold.

Table 1
Currency Decline Major Currencies
as Valued by Gold Price, March 31,
2001 – October 31, 2011



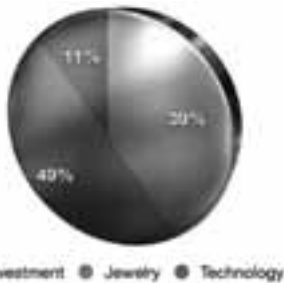
Source: fx.sauder.ubc.ca@2011 Bullion Management Group Inc.

As Mr. Barisheff, CEO, Bullion Management Group Inc. says, "The Bull Market in Gold is quite unique. Gold will increase in value not because the gold prices are rising but because currencies are falling!"

Increase in exports is one of the important determinants of growth in GDP; and currency devaluation is one of the popular tools used by countries to gain export competitiveness. But unfortunately as one country devalues its currency, other currency has to appreciate, giving export advantage

to one country at the cost of the other. As James Rickards said, "Not everyone can devalue against everyone else. But everyone can surely devalue against gold." which is once again bullish for Gold.

The demand for gold comes from mainly three sources: Investment, Jewelry and Technology.



Source: <http://www.goldetfs.biz>

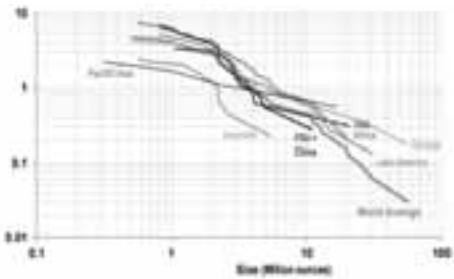
Though demand for jewelry may experience a slowdown, demand for gold in Investment Portfolios is likely to grow. Since 2009, the central banks around the world have been net buyers of gold. Large funds, which hold just about 1% of their portfolios in gold, will increase their purchases as the search for the Safe Haven intensifies. Demand from the general public may also grow as the currencies suffer a loss of purchasing power. In 2010, Chinese and Indian buying accounted for nearly 60% of annual global gold production from mines.

In spite of increase in demand, the supply of gold is unlikely to

increase at the required pace. Gold production over the last two decades has averaged annual increase of only 0.7%.

Gold's increasing cost of discovery and extremely cumbersome production process adds to the woes of the industry.

Table 2
Cumulative Number of Deposits
Found per \$1 billion
(June 2011 US\$)



Based on Primary Greenfield and Brownfield gold deposits found between 2001-10. Excludes Satellite Deposits.

Source: MinEx Consulting@November 2011

Conclusion

Finally, those who are stuck in the recallability trap and fear a repeat of the 1980s when gold prices fell very sharply need to be reminded that this surely is not 1980s. The ratio of paper currency to gold is way higher than in the 80s. Also, one of the important reasons for the fall in gold price in the 80s was sharp increase in the US interest rates due to Hawkish Stance of Chairman Volker leading to diversion of funds from Gold to the high yielding treasuries. In the current scenario such sharp rate hikes look highly unlikely as slow growth in demand and threat of Euro breakup looms large.

How much, how fast and how smoothly the Gold prices can go up may be a matter of speculation but all the existing pointers indicate that the bull market in gold is far from over.

After all as Ken Gerbino states,

“If you don’t trust gold; do you trust the logic of taking a beautiful pine tree, worth about \$4000 to \$5000, cutting it up, turning it into pulp and then paper, putting some ink on it and then calling it one billion dollars?”



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1. <http://online.barrons.com>; interview by Leslie Norton
2. Bullion Management Group, Associate Member of the London Bullion Market Association.
3. RBI Working Paper Series WSP (DEPR):14/2011
4. <http://fora.tv/>, The Buttonwood Gathering



Notes for Contributors

- **ANALYTIQUE** welcomes original articles or essays on any subject of interest related to commerce and industry such as macro economy, industrial performance, international trade, banking and finance, etc.
- Contributions must be no more than 4,000 words, including notes and references. And must be accompanied by an abstract of a maximum of 150 words in MS word. Tables, Graphs should be in MS Excel format.
- Contributions should be sent by e-mail at analytique@bombaychamber.com
- Contribution should not have been simultaneously submitted for publication to another Journal.
- Authors are requested to provide full details for correspondence: postal address, day-time phone numbers and e-mail address for our records. Only author’s affiliation and e-mail address will be published along with the articles unless otherwise directed.

INR: Vulnerability to Persist

Abhishek Upadhyay*

Abstract

INR has depreciated rapidly in the recent past, registering new lows against the USD. In this paper, we identify the drivers behind the currency's decline, with a special focus on the impact exerted by the de-leveraging pressures in the global banking system. In addition, we address the issue of the undervaluation of the INR. We conclude by assessing if a bounce back is likely in the value of INR against the USD, based on a valuation standpoint as well, and if the recent weakness in the currency would help India export its way out of troubles.

Introduction

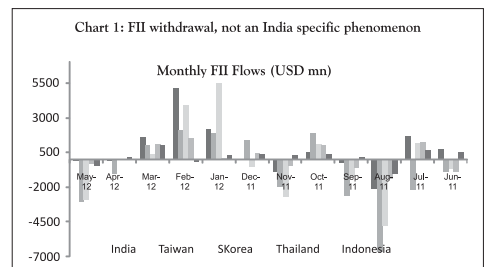
INR is now trading near its record lows seen recently, at beyond 56 levels against the USD. The currency has now lost almost one-fourth of its value against the dollar in the last one year, and has depreciated around 9% over the last two months, in a reversal of the trend seen earlier this year.

The INR decline can be seen in the backdrop of both domestic and global developments.

The Analysis

First, let us look at the global drivers of INR decline, with special focus on the impact of global de-leveraging pressures on India.

Speculation of a “Grexit” from the Euro Zone has gathered momentum after the popularity of the mainstream (pro-bailout) political parties came under question post the elections held in early May. Consequently, probability attached to a similar outcome in other bigger economies under tough austerity programs has increased as well (premium on Spanish ten year funding relative to Germany at record at 5% levels), weighing down on non-safe haven assets, including EM currencies such as INR (Chart 1).



Second, leveraging pressures in the global banking system has intermittently weighed on INR since late 2011.

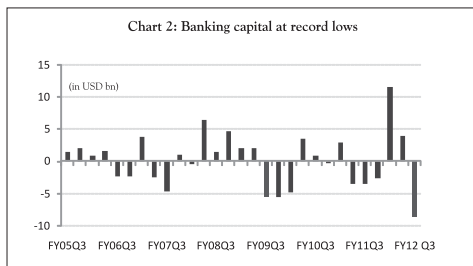
While the jump in global risk-off has pushed the INR to record lows,

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the de-leveraging pressures in the global banking system, particularly from the Euro Zone (EZ), has been intermittently weighing down on the currency since late 2011. This can be confirmed from the recently released data from the Bank of International Settlements (BIS) on the balance sheet exposure of the international banking systems, as well as the latest available Balance of Payments (BoP) data for India.

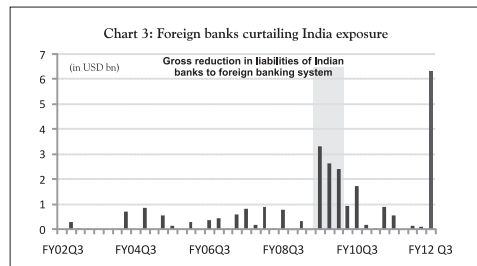
Third, banking capital at record lows.

The banking capital (the record of fluctuation in foreign assets and liabilities of commercial banks) on the capital account side of BoP was negative in Q3 FY12 (on a net basis). In recent history, the number had ventured into the negative territory in FY11 (when the EZ crisis was fanned by the developments in Greece) and in the second half of FY09 (after the Lehman collapse). More importantly, the reading is at a record low currently (Chart 2). Admittedly, the variations in the banking capital can be caused



by fluctuations in the assets of Indian banks abroad, as well as in the liabilities towards foreigners (banks and NRI's). Thus, to best delineate the possible impact of the deleveraging pressure in the foreign banking systems,

we may also look at the gross outflows in the balances the foreign banks maintain with the banks in India (This can be approximated by subtracting NRI flows from the Indian banks liabilities under the head banking capital on the debit side of India's BoP). Please refer to Chart 3, which



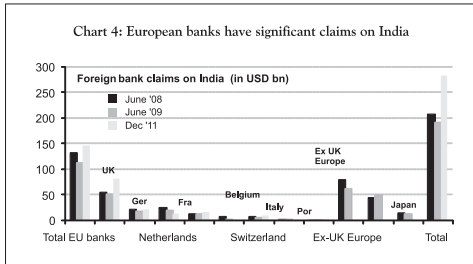
clearly reveals that there has been a significant pick up in the pace at which the foreign banks may be curtailing their "non-core exposures". The previous time such a trend was observed was in the quarters following the Lehman collapse in September 2008.

It is not possible to gauge which particular banking system is reducing its India exposure from the BoP release, but the recently released data from the BIS may give some cues.

Fourth, European banks reduced their Indian exposure by a record in Q3 FY12, the period when the aggregate BoP account turned negative.

As per the data from the Bank of International Settlements (BIS) on the balance sheet exposure of international banking systems, European banks have reduced the India exposure by USD 8 bn in Q3 FY12 to USD 146 bn. The de-leveraging was predominantly led by the UK banks that curtailed their exposure by USD 4.7 bn. For context, it may be remembered that

the European banks had reduced their balance sheet exposure to India by USD19bn between June 2008 and June 2009, in the one year period starting a quarter prior to Lehman collapse (Chart 4).



Now, these numbers need to be taken with a pinch of salt. The reason as per the BIS methodology, the reduction in claims may not necessarily imply capital outflow from the country. This is because even if a foreign bank extinguishes its exposure to an Indian entity abroad, it would be accounted as reduction in claims on India. However, given that the reduction in claims on India, which is mostly from the EZ banks, corroborates well with the outflows in the banking capital in the Balance of Payments (as highlighted above), we can be reasonably sure that the EZ banks were withdrawing funds from India in this period, rather than only cutting their exposures abroad to Indian entities.

The EZ banking exposure to India had been reduced by USD 5 bn in Q2 FY12. However, in that period, the BoP does not show any significant outflows, indicating reduction in exposure was carried on Indian entities abroad.

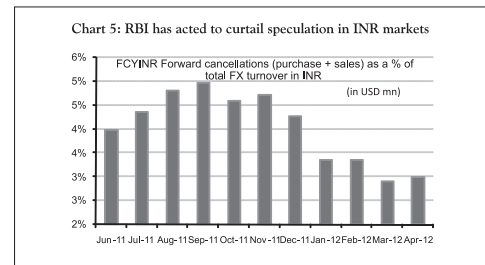
It is likely that the de-leveraging pressures remained prominent in the year to date (data not available beyond

Q3 FY12), although the impact of the long term refinancing operations from the ECB would have mitigated the pain in Q4 FY12. Given the crisis scenarios in play in the EZ, these capital repatriation pressures are likely to continue to weigh on INR in FY13.

Fifth, domestic drivers of the INR decline.

India specific factors certainly have a role to play as well, especially as the INR has underperformed its peers. The toxic mix of high fiscal deficits contributing to an unsustainable current account deficit and consequent inflation risks despite weak growth has magnified the impact of global risks aversion on the INR. Moreover, unless decisive steps are embarked upon to lower the subsidy bill as well as to attract FDI, such dynamics may not improve.

RBI is doing its bit to restrict volatility in the FX markets by way of active intervention as well as by series of administered measures to curtail the speculative trades (Chart 5). The capital account is also being progressively opened to attract flows, even as the move to augment debt flows is a double



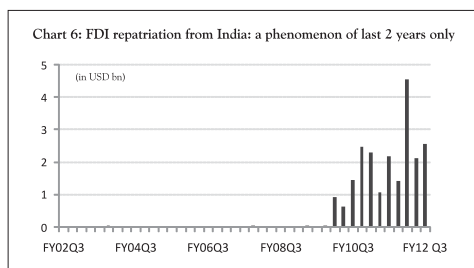
edged sword for it increases the country's external sector vulnerability as well. In this context, it may also be noted that the concerns on the reserve adequacy

(import cover at decadal lows of 7 months currently) would restrict a strong hand from the central bank, and such speculation has already weighed on the INR.

The ball is firmly in the Government's court now. A show of fiscal discipline by the Government would also help RBI to adopt a more accommodative monetary policy stance, while policy reforms would attract stable flows. To gauge if the perceived Government inaction is causing an impact on capital flows in India, we look at the FDI repatriation data from the BoP.

If we look at the FDI repatriation from India, which is phenomena of the last two years, we may ask the question as it is an offshoot of policy paralysis?

FDI outflows (gross basis) from India have picked up over the last two years, even as the inflows have grown significantly over the past decade (Chart 6). Considering we are referring only to flows that were intended to remain invested into the country for the long term, but finally had to be repatriated



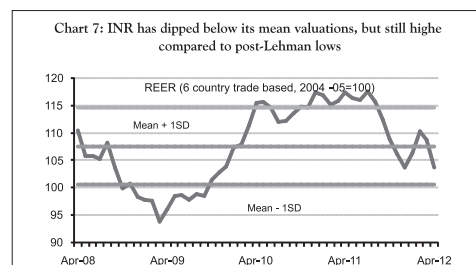
(and not to FDI investment abroad by Indian corporates that can be separately gauged from the BoP) insinuates at the possible policy paralysis in the country making it difficult for scheduled projects from going into implementation. It can thus be assessed that a positive surprise

from the Government in terms of policy reforms at this stage would help in not just attracting inflows, but possibly curtailing outflows as well.

Let us now briefly look at the issue of the undervaluation of the INR as well as the possible implications on growth of the recent currency depreciation, before concluding the analysis.

Isn't INR undervalued now, signalling a near term bounce back? It is difficult to assess the fair value of the currency, and academic literature suggests wide variances in estimates based on differing assumptions and methodology. However, even a simplistic exercise of observing the INR Real Effective Exchange Rate (REER) would be useful. To be sure, given the dominance of dollar invoicing of our trades, the fluctuations relative to the USD are undoubtedly important. But any gauge of domestic competitiveness should be broader, encompassing not only the relative movements in the currencies of our other important trade partners, but also the relative price levels compared to these economies. Such dynamics are appropriately captured by the Real Effective Exchange Rate (REER).

It may be noted from Chart 7 that the INR REER has now dipped at 12% from its highs in July'11, and is now below its mean valuations of the last 4 years,

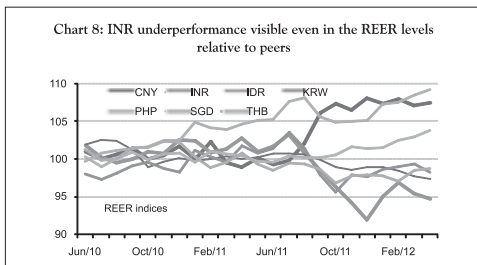


signalling undervaluation in a simplistic sense. However, it may also be observed that even as INR has slid to record lows against the USD, the currency is still significantly stronger compared to its lows in REER terms that were realised post the Lehman collapse. Thus, even if we conclude that the INR is undervalued currently, the magnitude of this misalignment can be much more. Consequently, it would be unfair to then comment that INR cannot depreciate more against the USD, purely from a valuation standpoint.

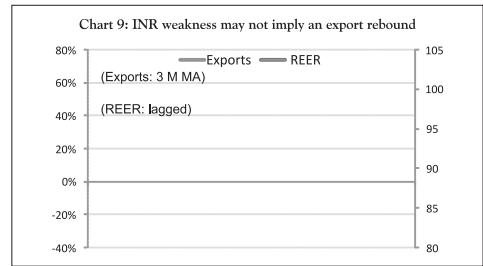
Another important point to note is that the INR REER traded more than one standard deviation below its mean levels for almost one year post the Lehman collapse. Expectations of any quick bounce-back premised on the undervaluation thesis may also thus not be suitable.

Lastly, the question can be raised, can India export its way out of trouble?

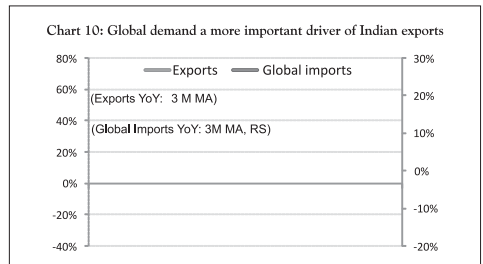
The broader INR underperformance can also be gauged by comparing the REER fluctuations of other regional EM economies, signalling greater competitiveness for the INR (Chart 8). However, is it then fair to conclude that India would be able to export its way out of troubles, by taking advantage of the weak INR. The answer is negative again. As the Chart 9 illustrates



well, the periods of improving export prospects have in fact been synchronous



with an increasing REER, which is an appreciating INR. The Indian exports seem to be more responsive to external demand prospects compared to just the currency valuations (Chart 10).



Conclusion:

To sum it all up, no quick relief may be expected in the India's BoP in FY13. The current account deficit may decline from the record lows seen in FY12 (estimated to have breached at 4% of GDP, which is much higher than the 3% seen at the time of BoP crisis in early 1990s), but not significantly unless the global commodity prices fall sharply. Add to this, the persisting concerns on the capital account, as has been highlighted above, the picture certainly does not seem encouraging for the BoP, and thus nor for INR, which may close FY13 much north of the 50 levels against the USD.



Introduction

This economy overview is being prepared against a backdrop of worrisome global and domestic macroeconomic developments. Sovereign default concerns and the need for substantial bank recapitalization in the Euro zone have escalated fears of contagion and recession. Even as governments respond by reducing public expenditure, widespread dissent against austerity and other harsh measures in times of rising unemployment have led to the fall of several incumbents. Confidence in the financial system is low and investors seem to have turned risk averse.

On the domestic front, slowing growth, elevated inflation and large fiscal and current account deficits are serious concerns. The already high fiscal deficit leaves little room for the Government to stimulate the economy. The current account deficit is being increasingly financed by debt flows, threatening long-term sustainability. On the positive side, the recent decline in petroleum prices, if sustained, can provide some relief. The projected normal monsoon and the inherent resilience of the Indian economy could provide the needed momentum to growth, provided appropriate policy actions are initiated to contain the

deficits and improve the investment climate. Further, despite some negative indicators, particularly on asset quality, the Indian financial sector has remained sound and resilient. Banks continue to be well capitalized with leverage at healthy levels.

I. Macroeconomic environment

The domestic economy has decelerated sharply

Domestic GDP growth declined sharply to 6.5 per cent during 2011-12 from 8.4 per cent in the previous year, weighed by global uncertainties as well as domestic cyclical and structural factors. The trend reflected the experience of similar EDEs, especially the BRICS countries. The deceleration in GDP growth was reflected across all the three segments of the economy – agriculture, services and industries. The downside risks to growth may persist given the headwinds from the global economy and moderation in private and government consumption and investment demand.

Inflationary pressures have moderated but risks remain

The persistence of overall inflation, in the face of significant growth slowdown, points to serious supply bottlenecks and sticky inflation

expectations. While falling global commodity prices could aid in checking inflationary trends in the coming months, the potential impact of the lagged pass-through of rupee depreciation, suppressed inflation in energy and fertilizers and possible fiscal slippage continue to pose a threat.

External sector risks aggravated; recent trends in oil prices provide comfort

The external sector vulnerability indicators point to increased risks. The current account deficit has deteriorated with decelerating growth in exports even as imports remained high on the back of sustained demand for gold and crude oil. The net international investment position of the country worsened with rising short term debt relative to total external debt. Falling international oil prices, if sustained, will help moderate external sector risks. But, domestic factors viz., a fast depreciating exchange rate, reduced capital inflows and the risk of downgrade of the sovereign rating of the country, continue to pose challenges for the financing of the deficit.

Trends in the composition of fiscal deficit pose concerns

Fiscal risks remain elevated, given that both fiscal and primary deficits have increased during 2011-12. Recent trends in terms of an elevated ratio of revenue deficit to gross fiscal deficit and the increasing proportion of revenue expenditure relative to capital outlays are also disquieting. Gross financing

needs of the Government remain high with consequent impact on private investment and growth.

Plans for fiscal consolidation afoot; risks of slippages remain

The Union Budget for 2012-13 set out a roadmap for fiscal consolidation during the 12th Five Year Plan period. The proposed fiscal consolidation for 2012-13 is primarily based on the revenue-raising efforts of the Government. The achievement of proposed reduction in the ratio of gross fiscal deficit to GDP would also depend on the commitment of the Government to contain its expenditure on subsidies within the stipulated cap of 2 per cent of GDP in 2012-13.

II. Financial Markets

India's foreign exchange market corrected and remained volatile

The turmoil in the Euro area, a widening current account deficit and perceptions of slowdown in policymaking in India affected the domestic foreign exchange market during the review period, resulting in a rapid depreciation of the Indian rupee. These trends were, however, broadly in line with the wider trend evidenced in case of currencies of EDEs, especially those with high current account deficits. A combination of administrative measures and foreign exchange market intervention were taken to address the stress.

Potential rating change could impact overseas borrowing

The process of deleveraging underway amongst European banks has had some impact on the cost of borrowing of Indian firms and banks. A change in the current external rating of the country could have 'cliff effects', impacting both, the availability and the cost of foreign currency borrowing for Indian banks and firms.

Financial Institutions Banks' reliance on borrowed funds growing

Credit growth in the banking sector decelerated to around 16.3 per cent in 2011-12, as compared with about 22.6 per cent as at end March 2011, reflecting the overall slowdown in the economy. Deposit growth also decelerated and, at less than 14 per cent as at end March 2012, was the lowest growth rate recorded in the past 10 years. The disproportionate slowdown in deposit growth vis-à-vis credit growth led to increased reliance of banks on borrowed funds, which may translate into liquidity risks.

Asset quality concerns persisted; comfortable capital position act as cushion

An increase in slippage ratios, rise in the quantum of restructured assets and a high rate of growth in Non Performing Assets (NPAs) relative to credit growth implied that the concerns on asset quality of banks remain elevated. The Gross NPA ratio for scheduled commercial banks (SCBs) increased to 2.9 per cent as at end March 2012 (2.4 per cent at end March 2011). The position is not alarming at the current juncture and

some comfort is also provided by the strong capital adequacy position of banks.

Growing interconnectedness warrants closer monitoring of the 'most connected' banks

Distress dependencies between banks have been on the rise, as evidenced by the trends in the Banking Stability Measures. The analysis of the network of the Indian banking system reveals that the maximum potential loss to the banking system due to the failure of the 'most connected' bank has risen during 2011. These trends would need to be carefully monitored, through rigorous micro prudential supervision of the 'more connected' banks.

Regulatory measures aim to mitigate risks from the rapid growth of gold NBFCs

The rapid growth of NBFCs engaged in lending against gold in recent years could pose risks due to the business model of such companies, concentration of business amongst a few companies and their growing interconnectedness with the banking system. These risks are sought to be addressed through various regulatory prescriptions.

Interconnectivities in the Indian financial system could pose risks

Insurance companies and mutual funds are the major lenders in the Indian financial system with banks, especially public sector banks, being the major borrowers. The insurance companies and mutual funds are, therefore,

vulnerable to the risk of contagion from the banking system. Banks, on the other hand, are considerably reliant on borrowings from these entities. As borrowings from mutual funds are largely short term, they could engender greater liquidity risks for the banking system.

A macro mapping of the non-banking financial segment may be warranted

Strengthening the regulatory framework for banks globally adds to risks of migration of financial sector activity to the relatively less regulated 'shadow banking' sector. In the Indian context, the non banking financial sector in the country functions within a regulatory framework appropriate to the activities undertaken by these entities. Nevertheless, a review of the extant regulatory arrangements and a complete macro mapping of all kinds of credit intermediation activities, with regulatory focus on more systemically important activities and entities, may be warranted in the light of the international reforms.

Financial institutions remain largely resilient to credit, market and liquidity risks

Credit risks continued to remain the primary source of vulnerability for banks, while risks from

adverse movements in interest rate appeared manageable, as evidenced by the results of a series of sensitivity stress tests. The banking system, as a whole, is, however, well positioned to absorb even severe credit risks stresses. Statutory Liquidity Ratio (SLR)

investments lend resilience to banks in managing their liquidity risks. A sample of banks reported a positive net marked to market (MTM) position on the derivatives portfolio, indicating that they are in a position to absorb adverse market movements in case of simulated historical stress scenarios and random sensitivity shocks.

NBFCs are also well positioned to withstand credit risk shocks given their comfortable capital adequacy positions. Stress tests conducted for Urban Cooperative Banks point to some vulnerability to both credit and liquidity risks.

Regulatory Infrastructure

Unintended consequences of key reform measures will need to be managed

Gaps and challenges in implementation of the post crisis reforms are emerging, especially with respect to the resolution framework for systemically important financial institutions and reforms in the OTC derivative markets. There could be unintended consequences of these reforms, particularly for EDEs. Differences in the calibration of reform measures in different jurisdictions may leave scope for regulatory arbitrage.

III. Macroeconomic Risks

The Euro area sovereign debt problem is continuing to weigh on global recovery. Although slowing global growth has dampened commodity prices, heightened risk aversion and

the resultant slowing of capital flows are likely to adversely impact emerging and developing economies (EDEs). On the domestic front, while growth has clearly decelerated, inflation risks remain. Notwithstanding the moderation in core inflation, the persistence of overall inflation, in the face of significant growth slowdown, points to serious supply bottlenecks and sticky inflation expectations. The increase in current account deficit (CAD), despite the slowdown in growth, is symptomatic of demand supply imbalances and a pointer to the need to resolve the supply bottlenecks. A widening CAD in the face of worsening global economic and financial conditions and muted capital flows has exerted downward pressure on the rupee. Prospects for increasing capital inflows depend on both global conditions, particularly a credible resolution of the Euro area situation, and an improvement in the domestic investment climate. Thus, key risks to domestic macroeconomic environment seem to arise from global sovereign debt problem and risk aversion, domestic fiscal position, widening CAD and structural aspects of food inflation.

Macroeconomic risks to financial stability higher since previous assessment

The uncertain global situation, rising risk aversion and slowing capital inflows, largely resulting from the Euro area sovereign debt problem are impacting the EDEs. They pose challenges to India's growth and balance of payments outlook.

Domestically, the widening CAD, lower levels of capital flows and increasing share of short-term debt in total debt heighten external sector risks. Fiscal slippages and slackening in growth in the recent quarters have enhanced the vulnerability to shocks. Risks from the corporate sector balance sheets have remained elevated due to relatively unfavorable domestic and external macroeconomic environment, e.g. subdued domestic consumption and investment demand, rising costs of inputs, deceleration in exports and risks from unhedged foreign currency. Risks in the household sector, however, have moderated

The Global Economy

Sluggishness in global recovery becomes more widespread...

The global economy remained on a slow recovery path during the period under review. Growth

in the advanced economies (AEs) remained sluggish in last quarter of 2011 and first quarter of 2012. IMF as well as the European Commission have indicated that the Euro area will undergo a mild recession in 2012. EDEs are also expected to slow down..

... with downside risks persisting

The slowdown in the Euro Area is spreading through trade, finance and confidence channels

to other AEs and to EDEs. In the short run, fiscal consolidation measures, especially in the Eurozone, could impact demand and growth adversely.

The recent string of rating downgrades of Euro area sovereigns and banks could raise borrowing costs. Growth, both in the Eurozone and in other parts of the world, is also likely to be affected by deleveraging by EU-based banks¹. EDEs, in particular, remain vulnerable to the spillovers of the accommodative monetary policies in AEs, especially in the Eurozone.

Global fiscal risks have intensified

Recent developments in the Euro zone, have led to an intensification of fiscal risks globally.

Debt and gross financing needs continue to be high in several AEs, even as sovereign yields are rising. There are concerns that the recession in the Eurozone may be used by countries to scale back or defer fiscal consolidation measures, especially in the current political climate. Relevant in this context is the observation by IMF in its Fiscal Monitor, April 2012, “. ... Should growth slow further, countries with fiscal space should allow the automatic stabilizers to operate freely and allow the deficit to rise to avoid excess fiscal contraction, which could worsen economic conditions. But short-term caution should not be an excuse to slow or delay efforts to put public finances on a sounder footing over the medium term...”

Elevated unemployment in the U.S. and rising unemployment in the Eurozone could add to risks

Unemployment in AEs remains high and could act as a drag on recovery and fiscal consolidation.

The unemployment rate in the US increased to 8.2 per cent in May 2012 from 8.1 per cent in April, the first increase in 11 months. Unemployment in the Euro area rose to 11 per cent in April 2012 - the highest rate on record. The unemployment rate is particularly acute in Spain (at nearly 24.3 per cent) and in the periphery Euro zone.

Trends in global growth are mirrored in global trade volumes....

The slowdown in global growth is reflected in sluggish trends in the volume of international trade. These trends are unlikely to reverse in short run given the uncertainties about the outlook for global growth.

The Domestic Economy

Domestic growth decelerated on the back of global and domestic factors

Domestic GDP growth declined sharply to 6.5 per cent during 2011-12 from 8.4 per cent in the

previous year, weighed by global uncertainties as well as domestic cyclical and structural factors. The trend reflected the experience of several EDEs, especially the BRICS countries.

Importantly, the quarterly growth rates have been showing a declining trend for the preceding four quarters with the fourth quarter GDP growth rate slowing to 5.3 per cent – the lowest quarterly growth rate in last 7 years .The slowdown in real GDP was reflected in all the major sectors. Growth rate in agriculture at 2.8

percent is due to the base effect (agriculture rate growth during 2010-11 stood at 7.0 per cent as against a trend growth of around 3.0 per cent). Slowdown in industrial activity is on account of weak demand for consumer durables, interest rate sensitivity, deceleration in external demand and subdued investment demand as well as a decline in business confidence amidst the prevailing interest rate environment. Manufacturing

slowed down from 7.6 per cent in 2010-11 to 2.5 per cent in 2011-12. During the same period, growth rate in the services sector moderated from 9.2 per cent to 8.5 per cent and the moderation was observed in several segments of the sector.

Subdued corporate investments and declining net exports dragged down aggregate demand...

All the major drivers of domestic demand, recorded sharp deceleration during FY12. The sharp moderation in real GDP at market prices from 9.6 per cent in 2010-11 to 6.9 per cent in 2011-12 was reflected in all components of aggregate demand – consumption (private and government), investment and net exports. Weakness in investment, in particular, has implications for the near and medium-term growth outlook.

..while declining savings and investment rates added to concerns

Both investment and saving rates declined in 2010-11. Gross domestic savings rate declined from 33.8 per cent in 2009-10 to 32.3 per cent in

2010-11 while gross capital formation rate declined from 36.6 per cent to 35.1 per cent. Corporate pipeline investment has shrunk and new investment remains subdued, affected by the domestic and global growth outlook, higher interest rates and rising input prices.

Given these trends, the outlook for domestic growth is unlikely to improve in the short term.

Headwinds from the global economy will continue to impact domestic growth in the coming

quarters. Going forward into 2012-13, downside risks to growth are likely to persist, especially if the monsoons are significantly below long period average. The index of industrial production increased by just 0.1 per cent in April 2012. Though the manufacturing Purchasing Managers' Index (PMI) for May 2012 suggested that industrial activity remains in expansionary mode the pace of expansion seems to have slowed down significantly. Demand conditions may also improve, though constraints might be faced due to low pipeline investments.

Inflationary pressures moderate but risks remain

Headline Wholesale Price Index (WPI) inflation has declined largely on account of transitory factors including a favourable base effect and seasonal decline in vegetable prices. The headline WPI inflation, which was above 9 per cent during April-November 2011, moderated to 6.9 per cent by end-March 2012,

consistent with the Reserve Bank's indicative projection of 7 per cent. The moderation was initially driven by softening of food prices and then by a decline in non-food manufactured products (core) inflation, which fell below 5 per cent for the first time in two years. However, headline inflation thereafter, inched up to 7.6 per cent in May 2012 driven mainly by food and fuel prices. Notably, the consumer price index (CPI) inflation (as measured by the new series, base year: 2010) increased sharply from 7.7 per cent in January, 2012 to 10.4 per cent in April, 2012.

Notwithstanding the recent moderation in global crude oil prices and domestic price pressures in manufactured products, upside risks to inflation remain. The likely trends in global crude oil prices, going ahead, remain uncertain. Moreover, the impact of the lagged pass-through of rupee depreciation, suppressed inflation in energy and fertilizers and possible fiscal slippage continue to pose a significant threat. While moderation in global commodity prices could aid in checking inflationary trends in the coming months, this could at least partially be offset by the depreciation of the rupee. Inflation risks are likely to remain high, given the persistence of overall inflation, even in the face of significant growth slowdown which points to serious supply bottlenecks and sticky inflation expectations.

External sector risks intensified as the external sector vulnerability indicators deteriorated

The external sector position weakened in the period under review, driven by a worsening CAD, rising external debt and weakening Net International Investment Position (NIIP).

All the key external sector vulnerability indicators – the reserve cover of imports, the ratio of short-term debt to total external debt, the ratio of foreign exchange reserves to total debt, the debt service ratio and NIIP-GDP ratio – deteriorated.

Prevailing global uncertainties accentuate risks to the CAD...

The trade deficit increased primarily because of the slowdown in global demand and the inelastic nature of oil imports. Pressures on the deficit were further aggravated by the fact that the non-oil imports remained high.

Given the uncertain global environment, the CAD is likely to remain elevated in the near term. Though export demand had benefitted in recent periods due to diversification of export markets to EDEs, export growth is likely to remain sluggish in the coming quarters as slowdown in AEs is increasingly affecting growth in EDEs. The widening CAD, notwithstanding slowdown in growth and depreciation of the currency, reflects the demand-supply imbalances and is a pointer to the urgent need to resolve the supply bottlenecks.

Softening of global oil prices and the recent moderation in imports of gold may alleviate the pressures on the external deficit. The CAD is also susceptible to deceleration in receipts

due to moderation of software exports, business services and investment income.

... leading to increased risks in financing the external deficit

Risks to financing the CAD have intensified in recent months. Global developments such as deleveraging by European banks have affected capital flows, especially to emerging markets like India. The moderation in capital inflows has necessitated financing of the CAD by drawing down foreign exchange reserves in recent quarters. This has weakened the external sector resilience of the economy.

Future capital inflows will depend on conditions in the global economy as well as the evolving domestic macroeconomic environment, including the pace of domestic policy reforms. Domestic factors including slowdown, potential downgrade by rating agencies and a depreciating exchange rate may affect capital.

Recent measures to encourage capital inflows may alleviate these risks

A host of administrative measures have been taken of late to improve inflows of external commercial borrowings (ECBs) and NRI deposits. The increase in the all-in-cost ceiling and other relaxations in ECB guidelines could facilitate overseas borrowings by corporates. Also, greater flexibility has been given to banks in mobilizing non-resident deposits by deregulating interest rates on NRE and NRO accounts in November 2011 and raising the ceiling on interest rates

on FCNRB in May 2012. Exporters have been asked to convert half the foreign currency balances in the EEFC accounts to the domestic currency. FII investment in non-convertible debentures / bonds issued by Indian companies in the infrastructure sector was enhanced to USD 25 billion and limit for investment in Government securities was raised to USD 20 billion. Such measures are expected to provide a reprieve to the pressures on the external sector.

Fiscal consolidation could aid the moderation of external risks...

If budget deficit is expanding and private sector savings and investment balance remains unchanged, high fiscal deficit can be financed only by expanding CAD. In the Indian context, the most visible link between the fiscal deficit and CAD is provided by oil prices. As prices for a number of petroleum products remain administered in the domestic market and are not significantly aligned to movement in international prices, a rise in international prices does not lead to demand adjustment in the domestic economy but rather results in a high import bill and higher CAD. On the other hand, under pricing of petroleum products with no moderation in domestic demand leads to rise in petroleum subsidies and hence expansion of fiscal deficit.

...As will waning gold imports

As discussed, imports have remained high given elevated global oil prices

and sustained domestic demand for gold. India has traditionally been one of the largest consumers of gold in the world. This could potentially pose risks as domestic production of gold is negligible and the demand has to be met almost entirely through imports. In 2011- 2012, India imported US\$ 45 billion worth of gold, an increase of 3 per cent year-on-year (despite a fall of 17 per cent in physical imports from 1034 tonnes to 854 tonnes). Gold imports constitute as much as 10 per cent of total imports. The import of gold is canalised and banks, MMTC Ltd., State Trading Corporations, etc. are authorized to import gold. Adverse movements in gold prices can also result in losses on loans portfolios of commercial banks and NBFCs. Recent administrative measures have, inter alia, led to some reduction in gold imports. Demand for gold is high in India on account of socio-cultural factors and its use in the informal economy. According to a World Gold Council study, as much as 23 per cent of all gold imported is for investment purpose in India. Even its use in jewellery at 75 per cent has an investment element for households. Banks' import of gold coins for retail sale to households has been a matter of concern.

It has risen from just one per cent of total imports by banks in 2009-10 to 3.8 per cent in 2011-12. Diversion of household savings into gold has implications for the availability of funds of the financial sector and thereby for growth. The high returns on gold in the recent past could underpin

demand, thus putting pressure on the CAD on an ongoing basis.

Fiscal risks on the rise....

Fiscal risks have risen in the period under review with both fiscal and primary deficits rising during 2011-12. The increased market borrowings by the government could crowd out private investment with implications for growth, besides posing challenges for monetary management. The proposed fiscal consolidation in 2012-13 is primarily based on the revenue-raising efforts of the central government.

The achievement of budgeted reduction in GFD-GDP ratio would also depend on the commitment of the government to contain its expenditure on subsidies within the stipulated cap of 2 per cent of GDP in 2012-13.

...Trends in the components of the fiscal deficit present some concerns

Trends in the various components of fiscal deficit of Centre throw up some disquieting features in terms of the elevated share of revenue expenditure in total expenditure and declining share of capital expenditure in total expenditure of Centre. There are concerns that the persistently high subsidy burden is crowding out public investment, especially at the current juncture when private investment is slowing down. There is another concern that the gross fiscal deficit of Centre continues to be predominantly structural rather than cyclical.

The ratio of revenue deficit (RD)

to gross fiscal deficit (GFD), which indicates the proportion of borrowings being used to finance current consumption has increased significantly since 2008-09, thereby reducing the availability of resources for capital investment. In recognition of this concern, the RD to GFD ratio of Centre is budgeted lower at 68.7 per cent for 2012-13, as against the ratio of 75.7 per cent for 2011-12 (RE).

Risks may be addressed by recent attempts at fiscal consolidation..... but will hinge on robust tax buoyancy and on capping of subsidies

The Union Budget 2012-13 sets out a roadmap for fiscal consolidation by budgeting a significant reduction in the ratio of gross fiscal deficit to GDP, beginning from 2012-13, thereby setting the stage for attaining a 'faster, sustainable and more inclusive growth' during the 12th Five Year Plan period.^{1.29} The fiscal correction for the ensuing year is primarily revenue-driven through widening of base of the services tax, stipulating a negative list of exempted categories in respect of services tax, rationalization of custom duty rates and partial rollback of crisis-related reductions in various indirect tax rates. The revenue outcome in 2012-13 would, however, hinge on the realization of the budgeted gross tax buoyancy which, at 1.39 for 2012-13, is significantly higher than the long-term average tax buoyancy of 1.11 for the period 2003-04 to 2011-12 as well as the average of 1.14 for the recent period 2010-11 to 2011-12.

On the expenditure side, there are

latent pressures on Central government finances for 2012-13. On the petroleum subsidy front, upside risks stem from volatile international crude oil prices and fluctuations in the exchange rate. Also, the budgeted growth of 3 per cent in food subsidies in 2012-13 appears to be modest when viewed in the context of the implementation of the Food Security Bill. Against this backdrop, the capping of subsidies by Central government at 2 per cent of GDP is a welcome step but avoidance of fiscal slippages would necessitate steps to allow fuller pass through of international crude oil and fertilizer prices.

Household Risks have moderated

Risks posed by the household sector have declined, as evidenced by the trends in the Macroeconomic Risk Map. Delinquencies in retail sector have moderated while growth in retail credit has decelerated. As debt-financed consumption continues to be low in India, it does not seem to be a source of significant risk from the perspective of the system as a whole.

Elevated corporate sector risks with rising costs and declining profits

Risks to health of the corporate sector in the economy remain elevated. Recent corporate results point to falling profitability due to rise in input costs, including interest costs, and moderation of external and domestic demand. Firm oil prices, stickiness in manufactured input prices, higher import costs associated with the depreciation of the exchange rate and

continuance of moderation in external and domestic demand emerge as important source of risks to the balance sheet of corporate and need to be monitored. Reserve Bank's Industrial Outlook Survey also indicated that the present industrial slowdown is expected to continue for some time.

IV. Financial Markets

Globally, uncertainty and risk aversion reigned in the financial markets as sovereign default risk, fragility in the banking sector and funding strains for sovereigns and banks continued to haunt the Euro area. Policymakers, posed with fresh challenges, had to innovate constantly to address the panic and keep the markets stable. Unconventional policy measures have been initiated by governments and central banks during the last two years, to deal with the situation. While the measures have brought temporary respite to the financial markets and the economies, the structural nature of the problems persist and the Eurozone crisis, remains a major threat to global financial stability. The improvement in sentiment in the early part of 2012 has given way to gloom as popular dissent against tough austerity measures has made it difficult for democratically elected governments to act. The concerns of a Greek exit from the European monetary union increased uncertainty during the period under review. The falling momentum in domestic growth in India as well as the rising current account deficit and the growing fiscal gap are eroding investor

confidence. While the domestic money and bond markets remain relatively unaffected by external turbulence, the foreign exchange and equity markets have witnessed high levels of volatility. A combination of foreign exchange market intervention and administrative measures have been taken to address the stress in foreign exchange markets. Sentiment in Indian equity markets is likely to remain tied to developments in global and domestic macroeconomic situation.

I. Global Markets

Lingering European debt crisis cast a shadow on financial markets

The European sovereign debt crisis had caused funding strains for sovereigns and, in their wake, for European banks since the onset of the financial crisis. This intensified towards the end of 2011. There was persistent uncertainty over the exact terms of fiscal relief for Greece. The rating downgrades of European banks and sovereigns have added to the strains experienced by financial markets.

ECB's policy support rescued sentiment temporarily

Stronger than expected US economic data and the European Central Bank (ECB)'s first three-year Longer-Term Refinancing Operation¹ (LTRO) in December 2011 were mainly responsible for changing market sentiment in early part of 2012 as investor risk appetite recovered. The ECB followed up the first round of LTRO in December 2011 with another

one in February 2012, taking the total policy support from this measure to over 1 trillion. The LTROs provided finance for stressed sovereigns and banks. Bank and sovereign CDS spreads tightened significantly. Strains in US dollar funding markets appeared to ease

Sovereign debt sustainability concerns resurfaced...

Policy measures proved unsuccessful in providing sustained relief. The broad financial market rally that followed the unconventional monetary policy measures taken in late 2011 and early 2012 has subsided. Global markets were concerned about elevated risks from Greece during the period under review. While the sizes of firewalls for fiscal risks in Europe have been raised, doubts over their capacity to support larger countries such as Spain or Italy in case of a contagion, have weakened market confidence.

...with widening of spreads on sovereign bonds

Sovereign CDS spreads have widened significantly, especially in Spain and Italy. Several institutions lowered risk limits for sovereign bonds of the troubled economies in Eurozone due to adverse developments and the higher notional losses on such bond holdings (as a result of higher volatility). This reduced the institutional appetite for bonds and affected their liquidity. The implied volatilities of the bond, stock, and foreign exchange markets point to an uncertain environment.

Structural issues remain to be addressed

Some European banks continue to be heavily reliant on wholesale funding. However, the maturities of bank borrowings have been shortened owing to market conditions. Further, their access to unsecured funds has also worsened. This fragility makes banks vulnerable to funding market freezes and has significantly increased their dependence on central bank support.

Rating agency, Moody's Investor Service cut ratings of 15 major banks by one to three notches, in another round of rating downgrades in mid-June 2012.

Accommodative monetary policy in advanced countries has externalities

In the United States, macroeconomic indicators point to a slow recovery, though the sustainability of the recovery remains uncertain. Central banks in advanced economies (AEs) are continuing their accommodative monetary policies. Policy rates have been at or near historic lows in many AEs, with a commitment to continue these levels for some more time. This, in turn, induces greater leverage and a progressive easing of lending standards. From a corporate issuer's point of view, the cost of raising fund by issuance of bonds has become more attractive, relative to equity. A surge in corporate borrowings could increase systemic leverage in the process. There are signs that continuously low interest rates may start to feed into a search-for-yield behavior in global financial markets.

II. Domestic Markets

Foreign exchange market exhibited considerable stress

Developments in Euro area and deterioration in global macro economy were among the factors that contributed to stress in the domestic foreign exchange market during the period under review. The other three components of the Financial Markets Stability Map (Chart 2.5), viz. banking sector funding, debt and equity markets, remained largely unchanged in comparison. The rise in the Financial Markets Stability Indicator (Chart 2.6) is largely driven by the fall in the rupee to historical lows and rise in its volatility.

Sovereign bond yields reflected fiscal slippages

Bond yields moved higher towards the end of March and early April 2012 on account of persistently tight liquidity conditions and an unanticipated rise in budgeted government borrowings for 2012-13. Subsequently they have stayed in a range between 8.5 per cent and 8.8 per cent for 10-year maturities. The financial markets remained unconvinced about the ability of the government to bring down the high level of fiscal deficit. The gross and net market borrowing of the Central Government through dated securities have been budgeted at ₹ 5696 billion and ₹ 4790 billion, respectively during 2012-13. This is higher by 11.7 per cent and 9.8 per cent, respectively over the last year. The Central Government proposes to finance only 2 per cent

of the budget through treasury bills, significantly lower than 22 per cent in 2011-12. A cut in the Reserve Banks' policy rate by 50 basis points, inter alia, brought 10-year government bond yields closer to 8 per cent.

Indian sovereign bond market remained largely insulated from overseas pressures

During the period under review, the rating agencies, S&P and Fitch, changed the outlook on Indian sovereign debt and 11 banks / institutions, from stable to negative. Though the government bond yields rose marginally on the news of change in the rating outlook, they quickly retraced. Since the Central Government does not borrow in the offshore markets and reliance on outside investors by way of Foreign Institutional Investment (FII) is limited, the impact was muted.

Liquidity conditions improved after tightness in March

Liquidity conditions in Indian money market remained tight, during the period under review, outside of the Reserve Bank's indicative comfort level of (+)/(-) one per cent of net demand and time liabilities (NDTL) of banks. Average net injection of liquidity under the daily liquidity adjustment facility (LAF) increased from around ₹ 0.5 trillion during April-September 2011 to around ₹ 1.6 trillion during March 2012. The increase in currency in circulation, quarterly tax outgo from all firms and the foreign exchange market intervention operations sucked liquidity out of the

banking system. The Reserve Bank injected liquidity by conducting open market operations (OMOs) and reducing the cash reserve ratio (CRR) by 125 basis points. The Systemic Liquidity Indicator exhibits the stress felt in funding liquidity for banks and others.

Rating change could impact the cost and availability of foreign currency borrowing

The process of deleveraging underway among European banks has raised the cost of borrowing for Indian firms and banks. Smaller borrowers have found their traditional funding lines withdrawn. A large part of foreign currency borrowings of Indian firms and banks is in the form of loans (External Commercial Borrowings) rather than bonds. The current external rating of India stands at BBB- (with a negative watch by S&P and Fitch and Baa3 by Moody's). A rating change could have some 'cliff effects'. This could affect both availability and cost of foreign currency credit lines for Indian corporates further. The impact is also being felt by Indian banks as they are the primary source of foreign currency denominated funding for Indian firms like buyer's credit. Indian financial institutions and non-banking financial companies (NBFCs) in the public sector have been large beneficiaries of FII investments in debt in the past. These institutions could also face the impact of a reduction in FII inflows.

Forex market remained volatile

Concerns over high twin deficits

of the country, re-emergence of global macroeconomic tensions and the European sovereign debt crisis have been the key factors behind the weakening rupee. The Reserve Bank has been using a mix of foreign exchange market interventions and administrative measures to address the volatility arising from tensions in the market place. The depreciation of the rupee followed the general trend of currencies of EDEs, especially those with high current account deficits.

Reserves fell moderately

Adequacy of reserves has emerged as an important parameter in gauging the ability of a country to absorb external shocks. At the end of September 2011, the import cover declined to 8.5 months from 9.6 months at end-March 2011. The ratio of short-term debt to the foreign exchange reserves was 21.3 per cent at end-March 2011 and it increased to 23 per cent at end-September 2011. The ratio of volatile capital flows (defined to include cumulative portfolio inflows and short-term debt) to the reserves increased from 67.3 percent as at end-March 2011 to 68.3 per cent as at end-September 2011.

With the changing profile of capital flows, the traditional approach of assessing reserve adequacy in terms of import cover has been broadened to include a number of parameters which take into account the size, composition and risk profiles of various types of capital flows as well as the types of external shocks to which the economy is vulnerable. In the recent period,

assessment of reserve adequacy is being done using some new measures, including 'Liquidity at Risk' (LaR). The LaR approach requires that a country's foreign exchange liquidity position could be calculated under a range of possible outcomes for relevant financial variables, such as, exchange rates, commodity prices, credit spreads etc.

Recent Rupee weakness found echo in stock market sentiment

The Morgan Stanley Capital International (MSCI) Emerging Markets index reported a first quarter gain of 13.2 per cent in Q1 2012. Stock markets in India mirrored the movement in other emerging markets in Asia and elsewhere. The initial optimism fuelled by increased liquidity provided by ECB and the resolution of uncertainties relating to the second debt package for Greece quickly waned. Retrenchment by FIIs in India (as also abroad) led to a correction in Indian stock indices back to their December 2011 lows. The US dollar rate of return to foreign investors worsened with the depreciation of the Indian rupee and this, in turn, reduced the attractiveness of Indian equity.

Some episodes have highlighted the possible risks from Algo and High Frequency Trades

In recent period, there have been many instances of extreme volatility and disruptions witnessed in Indian stock markets, resulting from various causes which can be directly or indirectly attributed to the increasing

use of Algorithmic⁵ (Algo) and High Frequency Trading (HFT)⁶. The Financial Stability Report of June 2011 had mentioned about the possible risk implications of a rapid move towards technological advancements like introduction of Direct Market Access (DMA) ⁷, facilitating Algo trading and HFT for Indian stock markets. In India only about 17 per cent and 11 per cent of cash market turnover in NSE and BSE respectively are on account of Algo and HFT in recent months. This proportion is much lower than that in developed markets like US and Europe.

Indian stock exchanges already have features like circuit breakers on stocks (having derivative trading) and indices, dummy price band for no band securities, quantity alert check, consolidated audit trail and trade cancellation policy and other risk reduction procedures to detect manipulation and deal with the possible risks.

There is a need to balance the need for technological advancements with a pragmatic approach to the intended benefits of the innovations. This assumes even more significance for India as efforts are being made to increase the retail participation in the Indian securities markets to change the largely institutional character of the market. The regulators and policy makers need to continue to assess the system-wide impact of such trading, from the perspective of current priority for a broad-based development of financial markets.



Select Economic Indicators

Agriculture & Industrial Production								
Sector-wise Percentage Change over Previous Year								
Item	Constant (2004-05) Prices				Current			
	2011-12		2010-11		2011-12		2010-11	
	Q3	Q4	Q3	Q4	Q3	Q4	Q3	Q4
Agriculture, Forestry & Fishing	3.1	2.8	11.0	7.5	10.1	7.4	21.0	16.0
Industry								
Mining and Quarrying	-2.8	4.3	6.1	0.6	14.9	23.8	22.1	14.5
Manufacturing	0.6	-0.3	7.8	7.3	8.6	5.6	14.3	15.2
Electricity, Gas & Water Supply	9	4.9	3.8	5.1	9.0	11.9	10.6	10.6
Services								
Construction	6.6	4.8	8.7	8.9	16.3	12.3	16.6	17.5
Trade, Hotels, Transport and Communication	7.0	10.0	9.7	11.6	18.6	12.9	16.5	17.8
Financing Institutions, Real Estates & Business Services	9.1	10.0	11.2	10.0	19.1	17.6	21.6	21.2
Communtiy, Social & Personal Services	6.4	7.1	-0.8	9.5	15.8	14.7	8.6	20.1
<i>Source: Ministry of Statistics and Programme Implementation, Government of India. Estimates of Gross Domestic Product.</i>								

Performance of Core-Industries		
Sector-wise Growth Rate (%) in Production (Weigh in IIP: 37.90 %)		
	April- May 2012-13	April- May 2011-12
Overall Index	3.4	5.0
Coal	5.9	2.0
Crude Oil	-0.4	10.4
Natural Gas	-11.1	-9.5
Refinery Products	1.8	5.5
Fertilizers	-12.4	3.1
Steel	5.8	5.5
Cement	9.7	-0.6
Electricity	5.3	8.4
<i>Overall Indices from 2012-13 & 2011-12</i>		
<i>Compiled by BCCI; Source of data Office of the Economic Advisor</i>		

External Sector

Exports and Imports (in US \$ million)				
Item	2012-13 (Apr-Mar)	2011-12 (Apr-Mar)	May	
			2012	2011
Exports	50136.76	50486.91	25681.38	26796.54
Imports	79888.84	81871.27	41947.14	45281.9
Oil Imports	28896.3	26148	14987.2	13144
Non-Oil Imports	50992.5	55723.2	26959.9	32137.9
Trade Balance	29752.08	31384.36	-16265.76	-18485.36

Source: Ministry of Commerce and Industry

Foreign Currency Assets	
For the Quarter April- June 2012	
Currency	Rate
USD	54.0625
GBP	85.5275
EURO	69.3200
JPY	67.5300
CHF	57.6800
AUD	54.5600
HKD	6.9650
SGD	42.7600
CAD	53.5200

Source: Foreign Exchange Dealers' Association of India



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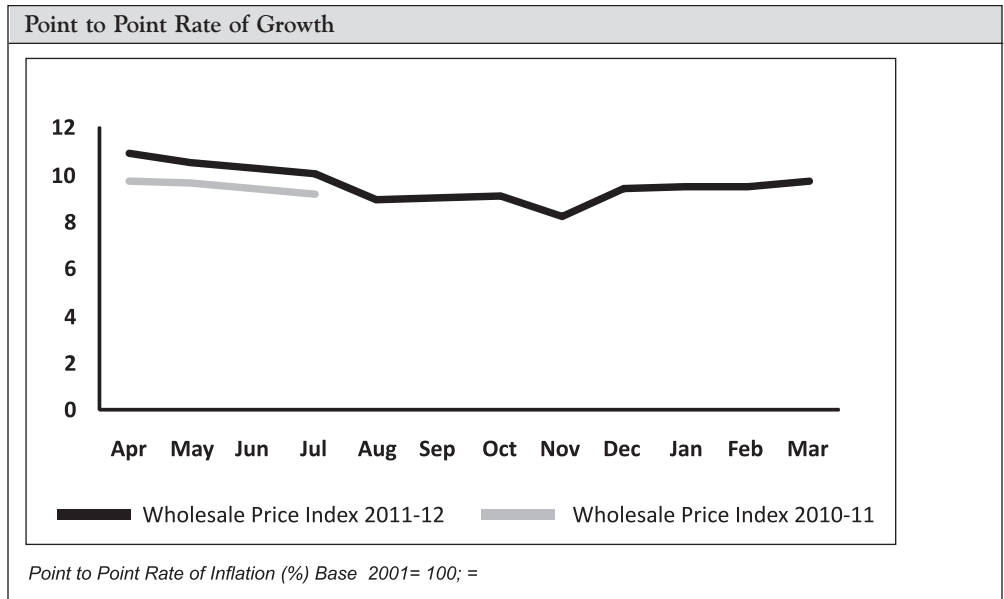
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Prices

Current price situation based on monthly Wholesale Price Index in May 2012 (Base: 2004-05=100)							
Items/Groups	Weight(%)	Cumulative change (%) Since March		Inflation (%) (Year-on-Year)		Inflation(%) Average of last 12 months	
		2012-13	2011-12	2012-13	2011-12	2012-13	2011-12
All Commodities	100	1.8	1.94	7.55	9.56	0.49	0.20
Primary articles	20.12	3.99	3.56	10.88	12.92	0.09	-0.97
Food Articles	14.34	4.67	4.08	10.74	8.25	-0.05	-0.27
Fuel and Power group	14.91	0.62	1.78	15.57	29.57	1.02	0.56
Manufactured Products	64.97	1.19	1.33	5.02	7.43	0.49	0.59



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World Prices of Select Commodities

Commodity	Unit	Annual Averages			Monthly Averages		
		Jan-Dec 2010	Jan-Dec 2011	Jan-May 2012	Mar 2012	Apr 2012	May 2012
Energy							
Coal, Australia	\$/mt	98.97	120.94	106.48	105.08	101.62	94.66
Crude Oil, average	\$/bbl	79.04	104.01	111.06	117.79	113.67	104.09
Crude oil,Brent	\$/bbl	79.64	110.94	117.35	124.93	120.46	110.52
Crude oil,Dubai	\$/bbl	78.06	106.03	114.5	122.28	117.25	107.05
"Crude oil, West Texas Int. "	\$/bbl	79.43	95.05	101.32	106.15	103.28	94.68
Natural gas, Europe	\$/mmbtu	8.29	10.52	11.52	11.97	11.42	11.64
Agriculture Beverages							
Coffee,robusta	c/kg	173.6	240.8	225.3	228.3	224.4	235.6
Tea,auctions(3),average	c/kg	288.5	292.1	268.6	242.4	279.1	299.0
Food							
Coconut oil	\$/mt	1124	1,730	1,341	1,338	1,348	1,155
Groundnut oil	\$/mt	1404	1985	-	-	-	2555
Copra	\$/mt	750	1,157	894	888	903	769
Palm oil	\$/mt	901	1125	1,117	1153	1,181	1,085
Palm kernel oil	\$/mt	1184	1,648	1,346	1,370	1,395	1,239
Soybean meal	\$/mt	378	398	427	421	463	496
Soybean oil	\$/mt	1005	1,299	1,258	1,287	1,310	1,218
Soybeans	\$/mt	450	541	540	543	575	573
Grains							
Barley	\$/mt	158.4	207.2	224.2	222.8	237.2	237.1
Maize	\$/mt	185.9	291.7	275.3	280.7	274.0	269.3
Rice,Thailand, 25%	\$/mt	441.5	506.0	-	-	-	-
Wheat, Canada	\$/mt	312.4	439.6	-	372.9	-	-
Sugar,world	c/kg	46.93	57.32	50.86	53.13	50.16	45.88
Raw Materials							
Logs,Malaysia	\$/cum	278.2	390.5	368.1	357.1	353.7	367.0
Plywood	c/sheets	569.1	607.5	612.3	611.0	611.6	611.6
Cotton A Index	c/kg	228.3	332.9	216.0	219.4	220.3	195.2
Rubber RSS3	c/kg	365.4	482.3	382.6	392.9	384.5	372.8
Metals and Minerals							
Aluminium	\$/mt	2,173	2,401	2,119	2,184	2,050	2,008
Copper	\$/mt	7,535	8,828	8,240	8,471	8,289	7,956
Gold	\$/toz	1225	1,568	1,662	1,674	1,650	1,591
Iron ore, spot, cfr China	c/dmt	145.9	167.8	141.9	144.7	147.6	136.6
Steel cr coilsheet	c/kg	816	892	900	900	900	900

Source: World bank-The Pink Sheet

Government Accounts

Trends in Central Government Finances: April-March 2011-12

Item	2010- 11 Actuals	April- March 2011-12			Variations Prov. Over RE, 2011-12 Absolute	Provi- sional 2011-12 as percent of RE	Per cent change 2011- 12(P) over 2010-11
		BE	RE	Provi- sional			
(1)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
(Rs. Crore)							
1. Revenue Receipts (2+3)	788,471	789,892	766,989	756,193	-10796	98.6	-4.1
Gross tax revenue	793,072	932,440	901,664	890,622	-11042	98.8	12.3
2. Tax (net to Centre)	569,869	664,457	642,252	631,886	-10366	98.4	10.9
3. Non Tax	218,602	125,435	124,737	124,307	-430	99.7	-43.1
4. Non- Debt Capital Receipts(5+6)	35,266	55,020	29,751	32,519	2768	109.3	-7.8
5. Recovery of loans	12,420	15,020	14,258	16,897	2639	118.5	36.0
6. Disinvestment Proceeds	22,846	40,000	15,493	15,622	129	100.8	-31.6
7. Total Non- Debt Receipt (1+4)	823,737	844,912	796,740	788,712	-8028	99.0	-4.3
<i>Memo items</i>							
Corporation Tax	298,688	359,990	327,680	323,250	-4430	98.6	8.2
Income Tax	146,587	172,026	171,879	171,108	-771	99.6	16.7
Union Excise Duty	138,299	164,116	150,696	145,205	-5491	96.4	5.0
Customs	135,813	151,700	153,000	149,489	-3511	97.7	10.1
Sevice Tax	71,016	82,000	95,000	97,578	2578	102.7	37.4
Total (Memo Items)	790,403	929,832	898,255	886,630	-11625	98.7	12.2
Devolution to States	219,303	263,458	255,414	255,414	0	100.0	16.5
8. Non-Plan Expenditure (a+b)	818,299	816,182	892,116	884,931	-7185	99.2	8.1
(a) On Revenue Account	726,491	733,558	815,740	806,820	-8920	98.9	11.1
<i>of which:</i>							
(1) Interest Payments	234,022	267,986	275,618	272,455	-3163	98.9	16.4
(2) Major Subsidies	164,516	134,411	208,503	146,951	-61552	70.5	-10.7
(3) Pensions	57,405	54,521	56,190	57,708	1518	102.7	0.5
(b) On Capital Account	91,808	82,624	76,376	78,111	1735	102.3	-14.9
9. Plan Expenditure (a+b)	379,029	441,547	426,604	413,513	-13091	96.9	9.1
(a) Revenue Account	314,232	363,604	346,200	334,095	-12105	96.5	6.3
(b) Capital Account	64,797	77,943	80,404	79,418	-986	98.8	22.6
10. Total Expenditure (8+9)	1,197,328	1,257,729	1,318,720	1,298,444	-20276	98.5	8.4
11. Revenue Expenditure (8a+9a)	1,040,723	1,097,162	1,161,940	1,140,915	-21025	98.2	9.6
12. Grants for Capita Assets	87,487	146,853	137,505	132,588	-4917	96.4	51.6
13. Capital Expenditure (8b+9b)	156,605	160,567	156,780	157,529	749	100.5	0.6
14. Revenue Deficit (1-11)	252,252	307,270	394,951	384,722	-10229	97.4	52.5
15. Effective Revenue Deficit (14-12)	164,765	160,417	257,446	252,134	-5312	97.9	53.0
16. Fiscal Deficit (7-10)	373,591	412,817	521,980	509,732	-12248	97.7	36.4
17. Primary Deficit (14-89a)(1)	139,569	144,831	246,362	237,277	-9085	96.3	70.0

Source: Review of Union Government Accounts, 2011-12 (Provisional/Unaudited).

Money & Banking

Money Stock – Components and Sources

(₹ Billion)

Items	Outstanding as on		Variation over (per cent)			
	2012		Financial Year so Far		Year on Year	
	Mar. 31	Jun. 1	2011-12	2012-13	2011	2012
M3	73,440.7	76,284.2	3.2	3.9	17.3	13.7
Components (i+ii+iii+iv)						
(i) Currency with the Public	10,266	10,752	5.1	4.7	16.0	12.2
(ii) Demand Deposits with Banks	7,002	6,705	-11.8	-4.2	-2.6	5.1
(iii) Time Deposits with Banks	56,142	58,813	5.0	4.8	20.6	15.1
(iv) "Other" Deposits with Reserve Bank	30.6	13.7	4.1	-55.1	5.3	-63.9
Sources (i+ii+iii+iv)						
(i) Net Bank Credit to Government (a+b)	23607.8	24803.9	4.6	5.1	20.0	19.5
(a) Reserve Bank	5296.7	5389.6	–	–	–	–
(b) Other Banks	18311.1	19414.3	7.3	6.0	12.4	14.0
(ii) Bank Credit to Commercaill Sector (a+b)	49502.8	50556.5	1.2	2.1	20.9	17.9
(a) Reserve Bank	39.6	56.0	–	–	–	–
(b) Other Banks	49463.2	50500.5	1.2	2.1	20.9	17.8
(iii) Net Foreign Exchange Assets of Banking Sector*	15236.7	16148.7	3.0	6.0	11.6	12.5
(iv) Government's Currency Liabilities to the Public	141.1	141.1	1.9	–	12.6	8.8
(v) Banking Sector's Net Non- Monetary Liabilities	15047.6	15366.0	-1.8	2.1	29.3	39.4
<i>of which</i>						
Net Non-Monetary Liabilities of RBI	5975.4	6899.7	9.3	15.5	30.8	71.3

*: Includes Investments in foreign currency denominated bonds issued by IIFC(UK) since March 20, 2009
 Note: Government Balances as on March 31, 2012 are before closure of accounts

Scheduled Commercial Banks – Business in India

Items	2012-13 Outstanding as on (Rs. Crore)		Percentage Variation			
	March 30, 2012	June 1, 2012	Financial Year So Far		Year on Year	
			2010-11	2011-12	2010	2011
Bank Credit	4,704,790	4,712,190	1.1	2.2	21.0	18.3
Non-Food Credits	4,625,000	4,600,140	0.1	-0.5	21.5	18.6
Aggregate Deposits	6,112,480	6,137,770	3.0	3.9	17.9	14.4
Investments in Govt. and other approved securities	1,744,960	1,845,930	7.5	6.2	12.1	14.4

Policy Rates / Interest Rates (per cent per annum)

Item / Week Ended	2011	2012
	June 3, 2011	June 1, 2012
Cash Reserve Ratio (per cent) (1)	6.00	4.75
Bank Rate	6.00	9.00
Repo Rate	7.25	8.00
Reverse Repo Rate	6.25	7.00
Prime Lending Rate (2)	9.25/10.0	10.00/10.50
Deposit Rate (3)	8.25/9.10	8.00/9.25
Call Money Rate (Low/High) (4)		
– Borrowings	7.30	8.10
– Lendings	7.30	8.10

- (1) Cash Reserve Ratio relates to the Scheduled Commercial Banks (excluding Regional Rural Banks).
 (2) Prime Lending Rate related to five major Banks.
 (3) Deposit Rate related to major Banks for term deposits of more than one year maturity.
 (4) Data cover 90-95 per cent of total transactions reported by participants.





Bombay Chamber of Commerce and Industry Trust for Economic and Management Studies

The Bombay Chamber of Commerce and Industry Trust for Economic and Management Studies was constituted in 1996 by the Bombay Chamber of Commerce and Industry to undertake independent research activities on various economic and management issues and for providing analytical views on macro-economic scenario, industrial performance and other issues of topical interest.

The Trust started publishing the quarterly magazine 'AnalytiQue' for the quarter October-December in the year of 1999 to serve as an effective vehicle of communication between the government, industry, economists, thinkers, management consultants and scholars. In its short journey the magazine had some trying spells and after the issue of January-March, 2006 there has been no issue. However, after four years, the Trust published the next issue of this Journal in March, 2010. While retaining its basic purpose and character, AnalytiQue now continues to serve members, who are drawn mainly from the world of business and commerce and deals with contemporary economic issues while documenting some of the important developments of the Indian economy.

Bombay Chamber of Commerce & Industry Trust for Economic and Management Studies

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