



Update on Indian Economy

November 2007

Economic Snapshot

| Contents | Item | Units | October | September | October | (% Change | |
|-----------------------------------|-------------------|---------------------|-----------------|------------------|-----------------|-----------|---------|
| | | | 2007 | 2007 | 2006 | [1] / [2] | [1]/[3] |
| | | | [1] | [2] | [3] | [4] | [5] |
| | | | | | | | |
| - Editorial | WPI -Index* | 1993-94=100 | 214.7 | 214.7 | 208.3 | 0.00 | 3.1 |
| - Capital Market | WPI -Inflation** | Per cent | 3.1 | 3.3 | 5.2 | | |
| - Country - UK | | Week ended | (06.10.07) | (08.09.07) | 07.10.06 | | |
| - Other Markets | IIP (93-94=100) | 2 months lag | 259.9 | 252.2 | 233.5 | 3.05 | 11.31 |
| - Important Policy Pronouncements | | | (Aug 07) | (July 07) | (Aug.06) | | |
| | INR / US\$ | Month End | 39.32 | 39.74 | 45.02 | (1.06) | (12.66) |
| | M3 | Rs. '000 Cr. | 3582.29 | 3487.13 | 2943.43 | 2.73 | 21.70 |
| | [i] Agg. Deposits | Rs. '000 Cr. | 3080.35 | 2993.08 | 2499.33 | 2.92 | 23.25 |
| | [ii] Currency | Rs. '000 Cr. | 501.93 | 494.05 | 444.10 | 1.60 | 13.02 |
| | | (Outstanding as on) | (12.10.07) | (14.09.07) | (13.10.06) | | |
| | Call Money | % Range | 4.00-6.65 | 1.00-7.50 | 5.25-6.95 | - | - |
| | (Lendings) | Week ended | (12.10.07) | (14.09.07) | (13.10.06) | | |

Source: RBI Weekly Statistical Supplement October 26, 2007 & Economic & Political Weekly October 27, 2007

*All Commodities. **Over the year.

Editorial

A) Domestic

The Federal Reserve of USA sprang a surprise on September 18, 2007 by reducing rate cut by 50 basis points though the market expectation was that the rate cut would be by 25 basis points. This rate cut was prompted by the difficult situation in the US because of the sub-prime mortgages. This led to the increased interest rate differentials between US and India, and given the fact that growth story in India is continuing the real GDP growth rate hovering around 9% the Foreign Institutional Investors pumped money into India through Participatory Notes (PNs). This caused not only acceleration in bull run but also led to the appreciation of the rupee. Realising that the flood of inflows through Participatory Notes, SEBI announced the registration of sub accounts to contain PNs and to have investment flows through regulated FIIs. Infact the Reserve Bank of India (RBI) has been for long arguing that the investors sending money through PNs be identified but the Government was of a different view, and now when the inflows have started impacting the exchange rate, and the stock market leading to the need for making appropriate policy changes, SEBI's announcement that the inflows through the PNs be regulated and should come through registered entities is a step in the right direction.

B) International

The IMF and World Bank Annual meetings were held in Washington during October 21-22, 2007 amidst the conflicting signs about prospects in the global economy, - the world oil price touching close to record highs and the falling dollar causing worries to the leaders of some of the advanced countries. The policy makers discussed the outlook for the global economy amidst the impact of market turbulence, aid to low income countries and climatic changes. These are perhaps the major issues discussed at Seminars beginning October 19, 2007 and were included as one of the agenda at the Annual General Meetings.

According to the World Economic Outlook (WEO) Update 2007 the global economic growth remained at about 5 percent annually on the strength of the Chinese economy gaining momentum by growing at 11 ½ percent for the first time and thereby making the largest contribution to the global growth evaluated by the market exchange rate as well as on purchasing power parity (PPPs) basis, and India continuing to grow at more than 9 percent and Russia at almost 8 percent. These three countries alone accounted for one half of the global growth over the past one year. Apart from that other emerging market and developing countries also maintained robust expansion. As a result rapid economic growth in these countries counter balanced the moderate growth in the US economy which grew at about 2 ¼ percent in the first half and subsequently the housing correction continued to apply a considerable drag on economic growth, and Euro area and Japan closed in the second quarter after achieving strong gains in the preceding two quarters.

World Economic Growth : Projections

| | (Annual Percent Change) | | | |
|---------------------|--------------------------------|-------------|------------------|-------------|
| | 2005 | 2006 | Projected | |
| | | | 2007 | 2008 |
| World output | 4.8 | 5.4 | 5.2 | 4.8 |
| United States | 3.1 | 2.9 | 1.9 | 1.9 |
| Euro area | 1.5 | 2.8 | 2.5 | 2.1 |
| Germany | 0.8 | 2.9 | 2.4 | 2.0 |
| Japan | 1.9 | 2.2 | 2.0 | 1.7 |
| Africa | 5.6 | 5.6 | 5.7 | 6.5 |
| Russia | 6.4 | 6.7 | 7.0 | 6.5 |
| China | 10.4 | 11.1 | 11.5 | 10.0 |
| India | 9.0 | 9.7 | 8.9 | 8.4 |

Source : IMF, World Economic Outlook Update, October 2007

However, during the year 2008, growth would remain a solid 4 ½ per cent supported generally by sound fundamentals and strong momentum in the emerging market economies. However, there are downside risks centering around the concern that financial market strains would continue and trigger a more pronounced global slowdown. The task for the policy makers would be to restore normal financial market conditions and safeguard the economic activity.

As regards **inflation** it was well contained in the advanced economies but the rising food prices continued to exercise pressures elsewhere. In the US, core inflation gradually subsided to below two percent largely on account of slowing in shelter cost. In the Euro area inflation generally remained below 2 percent this year.

Although, energy and food prices seem to have increased during September 2007, the prices in Japan have eventually remained flat. However, inflation has picked up in a number of emerging market and developing countries reflecting strong growth of domestic demand. The acceleration in food prices has reflected pressure from increased use of corn and other food items for biofuel production as well as poor weather conditions. The crude oil price have rebounded internationally to new heights creating problems for oil importing developing countries.

Capital Market Review

During the month of October 2007, the SENSEX of Bombay Stock Exchange (BSE) exhibited high volatility; the market which was continuing to march upward from the high of 19,051.86 on October 16, 2007 experienced set back following the hike in the Federal Reserve rate by 50 basis points to 4.75%. However, after the release of the discussion paper by SEBI on limiting foreign inflows via participatory notes (PNs), the Sensex declined to 17,559.98 points on October 19, 2007. This was the biggest fall witnessed by the market during the recent years i.e. 1,491.88 points or 7.8%. On the continual rise in the Sensex, the Finance Minister Mr. P. Chidambaram made statements on October 12, 2007 that steep rise in the stock market indices to record high **“worries me sometimes and sometimes surprises me”**. While there was a view that fundamentals have not changed, the Sensex continues to be driven by copious inflows of foreign funds from various sources. While the issue of limiting foreign inflows via participatory notes continued to be debated the market subsequently steadied, and according to some market participants the correction in the bull phase is long over due.

Continuous inflows of foreign funds led to the rise in the exchange rate of the rupee against US\$ and this rise was perhaps the highest during the last nine years. The Finance Minister felt that the present level of appreciation of the rupee vis-a-vis US dollar was outside the government's comfort zone, but the exchange rate has to be managed without hurting investors. Not only that exchange rate is to be maintained at competitive levels, the present situation has created a new situation over which we will have to develop mastery.

Until now, only the FIIs, and pension funds, insurance companies, mutual funds, foundations and endowments were permitted by SEBI to register with it for undertaking portfolio investment in India. However, hedge funds were not permitted. Hedge funds circumvented SEBI's restriction on them by becoming sub-accounts of some FIIs. The FIIs devised the system of issuing participatory notes (PNs) to the hedge funds. From the Indian perspective, this is a very opaque system.

Realising that the flood of inflows through Participatory Notes (PNs) were continuing and it was estimated that about 40% of the inflows were through the PNs, SEBI announced the registration of sub accounts. As the end of October 2007, the number of registered FIIs were 1,124 and number of registered sub account was 3470. Immediately, on the announcement by SEBI there was a correction in the market but subsequently the market started moving again but somewhat at a slower pace with the result the Sensex closed on October 31, 2007 at 19,837.99 from 17,291.1 on the last trading day on September 28, 2007, and thereby registered a rise of 2546.89 points or 14.73% during the month of October 2007. During the 2nd half of the month the market experienced small volatility and some correction.

| | October | September | October | September | (% Change | | |
|--|------------------------|------------------------|-------------------------|------------------------|-----------|---------|---------|
| | 2007 | 2007 | 2006 | 2006 | [1]/[2] | [1]/[3] | [2]/[4] |
| Major Indices | [1] | [2] | [3] | [4] | [5] | [6] | [7] |
| BSE Sensex – Close | 19837.99 (31.10.07) | 17291.10 (28.09.07) | 12961.9 (31.10.06) | 12454.42 (29.09.06) | 14.73 | 53.05 | 38.84 |
| Monthly High | 19977.67 (29.10.07) | 17291.10 (28.09.07) | 13,024.26 (30.10.06) | 12454.42 (29.09.06) | 15.54 | 53.39 | 38.84 |
| Monthly Low | 17328.52 (01.10.07) | 15422.05 (03.09.07) | 12,204.01 (04.10.06) | 11550.69 (11.09.06) | 12.36 | 41.99 | 33.52 |
| S&P CNX Nifty –Close | 5900.65 | 5021.35 | 3744.1 | 3588.40 | 17.51 | 57.60 | 39.93 |
| P/E Ratio : BSE – 30 | 25.52 | 23.25 | 21.25 | 21.34 | 9.76 | 20.09 | 8.95 |
| FII Investments (Equity+ Debt) | | | | | | | |
| Inflows – Rs. Cr. | 135411.8 | 71164.80 | 39573.9 | 34056.7 | 90.28 | 242.17 | 108.96 |
| Outflows – Rs. Cr. | 112321.7 | 52377.00 | 30903.9 | 27922.80 | 114.45 | 263.45 | 87.58 |
| Net – Rs. Cr. | 23090.4 | 18788.40 | 8669.6 | 6133.4 | 22.90 | 166.34 | 206.33 |
| Cum. Net Inv–US\$ Mn. (Month End) | 69316.8 | 63633.50 | 48806.8 | 46928.5 | 8.93 | 42.02 | 35.60 |

The net cumulative investment (equity and debt) were US\$ 69.32 billion at end-October 2007 as compared to US\$ 63.63 billion at end-September 2007. This reflects a rise of US\$ 5.69 billion or 8.94 per cent.

Country – UK

I Introduction :

The United Kingdom (UK) is one of the leading trading power and a financial centre in the world. It is a permanent member of the UN Security Council, and a founding member of NATO and of Commonwealth. Though it is a member of the European Union (EU) it has chosen to remain outside the Economic and Monetary Union (EMU). It has a population of 60.8 million (July 2007 estimate). The population in the age group of 0-14 years constitutes 17.2 per cent, and that 65 years and over 15.8%. The remaining population of 67 per cent is a working population in the age group of 15-64 years. Life expectancy at birth of the population is 79 years. However, the growth rate of the population is low at around 0.28 per cent and the fertility rate is 1.7 children born per women.

II UK Economy

The gross domestic product (GDP) at Purchasing Power Parity (PPP) estimated in 2006 is US\$ 1,928 billion. The real GDP growth rate in 2006 was 2.8 per cent and GDP per capita (PPP) US\$ 31,800. Sectorwise, composition of GDP in agriculture is one per cent, industry 25.6 per cent and services 73.4 per cent. The UK has large coal, natural gas and oil reserves with the result that primary energy production in the country accounts for 10 per cent of GDP which share is one of the highest in any industrial country. It is followed by services particularly in the area of banking, insurance and business services. The share of industry in GDP has been gradually declining in relative importance. Despite some setbacks in 2005 and 2006 when the output slowed down to 1.7 per cent and 2.7 per cent respectively the economy rebounded in 2007. In fact, the UK economy is now one of the strongest in Europe with inflation, interest rates and unemployment continuing to remain low. The efforts of Blair Government to make a case for Britain to join the European Economic and Monetary Union (EMU) did not succeed because of the large number of critics of political policy, and the fact that economy has been doing fairly well by being outside of the EMU. Public opinion polls indicate that majority of Britain's are still opposed to the Euro.

III UK Economy : Emerging Issues

Macroeconomic performance in the United Kingdom has been impressive, after softer growth in 2005, the acceleration in GDP in 2006 was broad based. Business investment was boosted by high net rates of return; residential investment grew by a pickup in house price appreciation; private consumption by robust employment growth, steady wage growth, and rising household wealth; and exports by the recovery in the euro area.

The financial sector is continuing to thrive and linkages with financial systems in other countries have grown. Net exports of financial services have risen steadily over the past decade and increased sharply in recent years.

The UK economy has resilience in the Financial system because the financial sector is in a strong position. (Annexure).

On the UK economy, it is said that, "The United Kingdom's macroeconomic performance over the past decade has been enviable. Not only has it secured the highest per capita GDP growth among the Group of Seven major industrial countries, but it has been done so with the lowest volatility while maintaining low and stable unemployment and inflation".

IMF Survey, April 2007, p114

Given the favourable medium-term outlook and the possibility that financial-sector and housing-related revenues may be temporarily high and according to the IMF building the fiscal cushions needed to respond to adverse shocks should be a priority.

IV India and UK : Merchandise Trade

Outside Europe, India is one of the major trading partners with UK. During 2006-07, India's total trade with UK was US\$ 9.7 billion which is more than double the trade of US\$ 4.7 billion in 1999-2000. During this period, the trade has gradually been increasing but the big jump came in 2003-04, when the trade experienced US\$ 1 billion increase every year. Merchandise exports from India to UK were US\$ 5.5 billion during 2006-07 and this constituted 4.4 per cent of total India's export of US\$ 126.3 billion. Similarly, merchandise imports of India from UK were US\$ 4.2 billion but the growth in this has been rather slow. At this level, Indian imports from UK constituted 2.2 per cent of the total Indian imports of US\$ 190.6 billion. This indicates that there is a considerable scope for trade with UK both imports and exports.

India's Trade with United Kingdom : Exports & Imports

(US\$ Million)

| Year (April- March) | Exports to UK (US \$ mn) | Total Indian Exports (US \$ mn) | Imports from UK (US \$ mn) | Total Indian Imports (US \$ mn) | Share (percent) of total Indian | | Total Trade with U.K (1+3) | India's Total Trade (2+4) |
|---------------------------|-----------------------------------|---|--|---|------------------------------------|--------------------|--|------------------------------------|
| | | | | | Exports to U.K. | Imports to U.K. | | |
| | 1 | 2 | 3 | 4 | 5 | 7 | 8 | 9 |
| 1999-00 | 2,035 | 36,822 | 2,707 | 49,671 | 5.53 | 5.45 | 4,742 | 86,493 |
| 2000-01 | 2,299 | 44,560 | 3,168 | 50,537 | 5.16 | 6.27 | 5,467 | 95,097 |
| 2001-02 | 2,161 | 43,827 | 2,563 | 51,413 | 4.93 | 4.99 | 4,724 | 95,240 |
| 2002-03 | 2,496 | 52,719 | 2,777 | 61,412 | 4.73 | 4.52 | 5,273 | 114,131 |
| 2003-04 | 3,023 | 63,843 | 3,234 | 78,149 | 4.74 | 4.14 | 6,257 | 141,992 |
| 2004-05 | 3,681 | 83,536 | 3,566 | 111,517 | 4.41 | 3.20 | 7,247 | 195,053 |
| 2005-06 | 5,059 | 103,091 | 3,930 | 149,166 | 4.91 | 2.63 | 8,989 | 252,257 |
| 2006-07 | 5,547 | 126,331 | 4,172 | 190,566 | 4.39 | 2.19 | 9,719 | 316,897 |

Source: RBI: (i) Handbook of Statistics on Indian Economy 2006-07;

V Indo-British Sectoral Focus

Among the sectors that have been identified for focus in the sphere of bilateral trade are :-

(i) Goods – engineering goods, textiles, gems and jewellery, natural stone, marine products, chemicals, rice, processed foods, alcoholic beverages, non-GM produce like soya, and pharmaceuticals including complementary medicine; and ii) Services – software, biotechnology (R&D, information exchange and product development), healthcare and media.

Biotechnology has been identified as one of the main areas for enhanced cooperation. Leading Indian biotechnology companies are collaborating with clients across UK and Europe. Astra Zeneca has established an R&D Centre in Bangalore. GlaxoSmithKline and Ranbaxy have signed an agreement for joint research and development. Industry delegations from both countries have visited each other regularly.

Healthcare is another potential area of cooperation. India already supplies doctors and nurses in substantial numbers for UK's National Health Service. Indian pharmaceutical companies also market their products and have even invested in production facilities in the UK. UK is also a source for medical equipment. The Indian Healthcare Federation comprising top Indian Private sector healthcare organizations and super-specialty hospitals visited UK in September 2003 to explore potential partnerships and opportunities.

VI Indo-British Partnership Programme

In response to opportunities created by the bold and imaginative liberalisation programme introduced in India, the then British and Indian Prime Ministers publicly endorsed the creation of the Indo-British Partnership Initiative (IBPI) in 1993. Its mandate is to increase bilateral trade and investment with particular emphasis on small and medium enterprises, and to promote technology and science links between the two countries.

Backed by the two Governments and led by industry, the initiative has become an ongoing Partnership and is now called the Indo-British Partnership (IBP). In India the IBP secretariat is managed by the Confederation of India Industry (CII) in collaboration with the Federation of Indian Chambers of Commerce and Industry (FICCI), the Trade & Investment department of the British High Commission, and in the UK by Asia House under the guidance of the UK Trade & Investment. It is led by co-chairmen N.R. Narayana Murthy, Chairman & CEO of Infosys Technologies Ltd and Karan Billimoria, CEO of Cobra Beer.

UK is the third largest overseas investor after Mauritius and the US in terms of new investments approved. Excluding investment from Mauritius, UK is the second largest foreign direct investor in India after the US.

More than 2000 joint ventures have been signed between Indian and UK companies since 1993. UK is the largest market for Indian IT services (12% of IT services exports -- nearly \$1 billion).

Recently, in September 2007, when the new British High Commissioner, Mr. Richard Stagg presented his credentials to the President of India, and he said "it was a privilege for him to take on the challenge of building on the strengths of the unique UK-India partnership and to carry forward the huge and broadening agenda of bilateral cooperation". He further remarked that,

"It is an exciting time for all of us engaged in promoting the bilateral links, whether business government, cultural or social. Almost all of the British Government's International Strategic Priorities involve stepping up our engagement with India".....

"They cover a wide range of sectors. Foreign and defense policy; counter-terrorism and counter-proliferation, economic and trade policy; science, education, and innovation; environment and sustainable development; as well as vibrant people-to-people contact will work to make the bilateral relationship even more meaningful for both our great nations," the High Commissioner said.

Annexure : Important Macroeconomic Variables : UK economy

| | | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 Est | 2007 Proj. |
|-----|--|------|------|------|------|------|-------------|---------------|
| I | Real Economy | | | | | | | |
| | Real GDP (change in percent) | 2.2 | 2.1 | 2.7 | 3.3 | 1.9 | 2.7 | 2.9 |
| | CPI | 1.2 | 1.2 | 1.4 | 1.3 | 2.1 | 2.3 | 2.3 |
| | Gross national saving (percent of GDP) | 15.0 | 15.2 | 15.1 | 15.3 | 14.8 | 15.0 | 15.4 |
| | Gross domestic investment (percent of GDP) | 17.2 | 16.8 | 16.5 | 16.9 | 17.2 | 17.9 | 18.5 |
| II | Public Finance | | | | | | | |
| | General Government Balance | 0.0 | -2.1 | -3.0 | -3.2 | -2.8 | -2.5 | -2.1 |
| | Public sector net debt | 30.1 | 31.9 | 33.2 | 34.9 | 36.3 | 37.5 | 38.3 |
| III | Interest rates (year average) | | | | | | | |
| | Three-month interbank rate | 4.9 | 4.0 | 3.7 | 4.6 | 4.7 | 4.8 | -- |
| | Ten-year government bond yield | 4.9 | 4.8 | 4.5 | 4.9 | 4.4 | 4.5 | -- |
| IV | Balance of Payments | | | | | | | |
| | Exports (percent of GDP) | 27.4 | 26.4 | 25.7 | 25.4 | 26.4 | 28.1 | 25.8 |
| | Imports (percent of GDP) | 30.1 | 29.3 | 28.4 | 28.4 | 30.1 | 32.4 | 30.1 |
| | Trade balance (in percent of GDP) | -2.7 | -2.9 | -2.7 | -3.0 | -3.7 | -4.3 | -4.3 |
| | Current account balance (in percent of GDP) | -2.2 | -1.6 | -1.3 | -1.6 | -2.4 | -2.9 | -3.1 |
| | Net exports of oil (in billions of US dollars) | 8.0 | 7.7 | 5.5 | 1.6 | -4.0 | -7.2 | -- |
| V | Exchange Rates | | | | | | | |
| | Exchange rate regime | | | | | | Floating | |

Source : IMF(PIN of March 2006 & February 2007)

Other Markets

Debt Market

Several banks and financing entities came to the market and issued debt instruments; among these was the State Bank of India which topped the list with an upper Tier-II bond issue worth Rs.1,000 crore. Public sector entities like Power Finance Corporation Ltd. and Rural Electrification Corporation Ltd. each issued bonds worth Rs.500 crore, while Export-Import Bank of India had two separate issues totalling Rs.625 crore. Other major issues were from Allahabad Bank, Indian Hotels Company Ltd. and State Bank of Patiala.

| | Name of the Issuer | Rate % | Duration | Rating | Amount Rs. Crore | Type of Instrument |
|------------|--|--------------------|------------------------|--------|---------------------|----------------------------|
| I. | Bank | | | | | |
| i) | Allahabad Bank | 10 | 10 years | AA+ | 400 ^a | Bonds |
| ii) | Bank of India | 10.45 | Perpetual | AA+ | 100 ^a | Perpetual Bonds |
| iii) | Export-Import Bank of India | 9.10 | 3 years ^b | AAA | 500 ^a | Bonds |
| iv) | Export-Import Bank of India | 9.58 9.65 | 2 years 3 years | AAA | 125 | Bonds |
| v) | Indusind Bank Ltd. | 10.35 | 67months | A+ | 45 ^c | Tier II Bonds |
| vi) | Kotak Mahindra Bank Ltd. | 10.30 ^d | 15 years ^e | AA | 100 ^a | Upper Tier II Bonds |
| vii) | Kotak Mahindra Bank Ltd. | 9.95 ^d | 15 years ^e | AA | 20 | Upper Tier II Bonds |
| viii) | State Bank of India | 10.10 | 15 ^e | AAA | 1000 ^h | Upper Tier II Bonds |
| ix) | State Bank of Indore | 10.25 ^d | Perpetual ^e | AAA | 165 ^a | Perpetual Bonds |
| x) | State Bank of Patiala | 9.90 ^d | 15 years ^e | AAA | 300 ^a | Upper Tier II Bonds |
| xi) | Yes Bank Ltd. | 10.70 ⁱ | 15 years ^e | A+ | 50 | Upper Tier II Bonds |
| xii) | Yes Bank Ltd. | 11 ⁱ | Perpetual | A+ | 25 | Perpetual Bonds |
| II. | NABARD | 9.50-9.65 | 3 years ^f | AAA | 200 | Bonds |
| | | 9.70-9.80 | 5 years | | | |
| III | Financial Service Ins. | | | | | |
| i) | Andhra Pradesh State Finance Corporation | 9.10 | 5 years | A | 50 | Bonds |
| ii) | Global Trade Finance Ltd. | 10.40 | 67 months | AA | 25 | Non-convertible debentures |
| iii) | Housing Development Finance Corporation Ltd. | 10.10 | 10 years | AAA | 250 | Bonds |
| iv) | Indian Hotels Company Ltd. | 9.86 | 3 years | AA+ | 300 | Bonds |
| v) | Power Finance Corp.Ltd | 9.80 | 5 years | AAA | 500 ^a | Bonds |
| vi) | Rural Electrification Corporation Ltd | 9.85 | 10 years | AAA | 500 ^g | Bonds |
| vii) | Sundaram Finance Ltd. | 10.27 | 3 years | AA+ | 25 | Bonds |

a. With an unspecified greenshoe option

b. Put/ Call at the end of one year

c. With a greenshoe option of Rs.35 crore

d. With an increase of 50 bps if call is not exercised

e. Call option at the end of 10th year

f. Put/Call at the end of two years

g. With a green shoe option of Rs.1,000 crore

h. With a green shoe option of Rs500 crore

i. With an increase of 100 bps if call is not exercised.

(Source:: Credit Analysis & Research Ltd., October 2007)

Call Money Market

The call money market rate on October 12, 2007 in respect of borrowings ranged between 4.00% and 6.65% as compared to the rates of 5.25% - 6.95% on October 13, 2006 (i.e. a year ago) reflecting that there was moderate softening of the interest rates. The average daily turnover in the call money market was Rs.7,330 crore for the week ending October 12, 2007 and this daily turnover rose to Rs.10,863 crore in the week ending October 19, 2007.

Foreign Exchange Market

The exchange rate (RBI reference rate) on October 19, 2007 was Rs.39.79 per US dollar as compared to Rs.39.31 per US dollar on October 15, 2007, that is, a week ago; this reflected a small depreciation of the rupee vis-a-vis US dollar. Further, the six month forward premia was 0.90% on October 19, 2007 as compared to a premium of 1.98% on October 15, 2007 (a week ago), and this reflects that supply of dollars is likely to become relatively comfortable in the forthcoming weeks. The foreign currency assets were US\$ 253.32 billion on October 19, 2007, and inclusive of gold and SDRs and the reserve position in the Fund, the foreign exchange reserves aggregated to US\$ 261.14 billion. From end-March 2007, the foreign exchange reserves registered a rise of US\$ 61.96 billion upto October 19, 2007. The market rate (buying) was Rs.39.41 per US dollar on October 31, 2007. The RBI intervened occasionally into the market by buying dollars in a bid to curb the rise of rupee.

Important Policy Pronouncements

A. The Reserve Bank of India (RBI) Governor Yaga Venugopal Reddy announced the Mid-term Review of Annual Policy Statement for the year 2007-08 on October 30, 2007 and the highlights of the Policy are

I. Overview :

- 2007-08 GDP growth forecast retained at 8.5%.
- Inflation to be contained close to 5% during this year.
- Bank deposits growing at 25% while loan growth slows to 23%.

II. Macro-Economy :

- Real GDP growth during April-June 2007 at 9.3 per cent as against 9.6 per cent in the corresponding quarter last year. Real GDP growth originating in agriculture, industry and services sectors was 3.8 per cent, 10.6 per cent and 10.6 per cent, respectively, in the first quarter of 2007-08 as against 2.8 per cent, 10.6 per cent and 11.6 per cent a year ago.
- The index of industrial production (IIP) rose by 9.8 per cent during April-August 2007 as against 11.0 per cent in the corresponding period last year. Manufacturing output increased by 10.3 per cent (12.2 per cent a year ago) while mining activity and electricity generation rose by 5.4 per cent (3.0 per cent) and 8.3 per cent (5.7 per cent), respectively.

- Inflation, measured by variations in the wholesale price index (WPI) on a year-on-year basis, eased from its peak of 6.4 per cent on April 07, 2007 to 3.1 per cent by October 13, 2007. On an average basis, however, annual WPI inflation at 5.2 per cent was higher than 4.6 per cent a year ago. Excluding food, headline WPI inflation was 3.0 per cent as against 5.0 per cent a year ago. Other items that contributed to headline inflation included cement, drugs and medicines, iron and steel and electrical machinery.
- In the foreign exchange market, large surplus conditions in the spot market resulted in a sharp increase in average daily turnover to US\$ 52.9 billion in mid-September 2007 from a level of US\$ 27.5 billion a year ago. While the inter-bank turnover increased from US\$ 20 billion to US\$ 37.6 billion, the merchant turnover increased from US\$ 7 billion to US\$ 15.2 billion.
- During the second quarter of 2007-08, equity market activity recorded a pick-up in terms of issuances in the domestic primary segment as well as in international stock exchanges. The BSE Sensex (1978-79=100) increased from 13,072 at end-March 2007 to cross the 15,000 level on July 9, 2007, the 16,000 level on September 19, 2007, the 17,000 level on September 27, 2007, the 18,000 level on October 9, 2007, the 19,000 level on October 15, 2007 and closed at 19,243 on October 26, 2007.

III. Monetary Measures :

(a) Bank Rate

The Bank Rate has been kept unchanged at 6.0 per cent.

(b) Repo Rate / Reverse Repo Rate

- The repo rate under the LAF is kept unchanged at 7.75 per cent.
- The reverse repo rate under the LAF is kept unchanged at 6.0 per cent.
- The Reserve Bank has the flexibility to conduct repo/reverse repo auctions at a fixed rate or at variable rates as circumstances warrant.
- The Reserve Bank retains the option to conduct overnight or longer term repo/reverse repo under the LAF depending on market conditions and other relevant factors. The Reserve Bank will continue to use this flexibility including the right to accept or reject tender(s) under the LAF, wholly or partially, if deemed fit, so as to make efficient use of the LAF in daily liquidity management.

(c) Cash Reserve Ratio

The cash reserve ratio (CRR) of scheduled banks is currently at 7.0 per cent. On a review of the current liquidity situation, it is considered desirable to increase the CRR by 50 basis points to 7.5 per cent with effect from the fortnight beginning November 10, 2007.

IV. Credit Delivery Mechanism :

It has been the endeavour of the Reserve Bank to address the developmental needs of sectors of the economy that are disadvantaged in the credit market, especially agriculture and SME's, by improving credit delivery mechanisms and making available basic banking services to the widest sections of the society without procedural hassles. Initiatives taken in this regard include refocus on employment-intensive sectors under priority sector lending; simplification of the procedures for obtaining agricultural loans; reducing of risk weight on loans extended against gold and silver; augmenting credit flow to distressed farmers; revival of the cooperative structure and regional rural banks (RRBs); development of new avenues of credit dispensation such as micro-finance institutions; and legislation for regulating money lending, deepening financial inclusion and improving customer services.

V. Third Quarter Review :

The Third Quarter Review of the Annual Policy Statement on Monetary Policy will be undertaken on Tuesday, January 29, 2008.

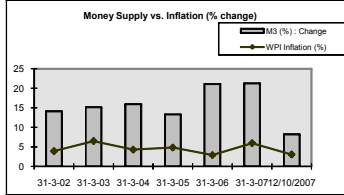
VI. Concluding Observations :

The RBI Governor faced a critical situation during the month of October 2007 in the sense that the impact of Fed rate cut by 50 basis points tended to increase the differential in interest rates between India and USA which would help inflows thereby leading to the surge in the money supply on one hand, and appreciation of the Indian rupee vis-a-vis US dollar on the other. This also represented hidden inflationary expectations though the wholesale price index excluding pricing of food articles was well contained.

The Governor, therefore, resorted to hike in CRR rate to drain out excess money from the banking system though the hike in the CRR may not be adequate in the situation when inflows continue to maintain their momentum.

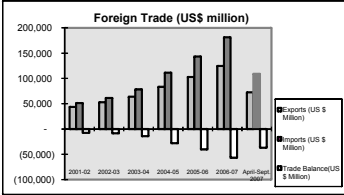
One alternative could be that the Governor may resort to, in addition to present hike in the CRR, more capital controls depending upon the volume and speed of the inflows in the Indian system in the near future. Another alternative may be the Governor may gradually reduce the interest rates but given the requirement of resources for the growing economy like India, the reduction in the interest rates may turn out to be the last resort about which the Governor may think in the next Annual Policy Statement scheduled on January 29, 2008.

B. In the USA Third Quarter Economic Growth (January-September) of 2007 was reported to be solid and strains in the financial markets had eased somewhat on balance. However, the pace of economic growth in the near term is likely to slow reflecting partly the intensification of housing correction. It is because of that the Federal Open Market Committee (FOMC) decided on October 31, 2007 to cut again the Federal Fund's rate by 25 basis points to 4.50 per cent.



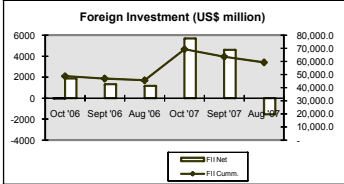
| | 31-3-02 | 31-3-03 | 31-3-04 | 31-3-05 | 31-3-06 | 31-3-07 | 12/10/2007 |
|-------------------------------|-----------|-----------|-----------|-----------|-----------|-----------|------------|
| M3 (Rs. Crore) | 14,98,355 | 17,25,222 | 20,03,102 | 22,53,938 | 27,29,535 | 33,10,278 | 35,82,288 |
| M3 (%) Change | 14.1 | 15.14 | 15.95 | 13.30 | 21.10 | 21.27 | 8.20 |
| WPI (Index) All CommoditiesSS | 161.8 | 172.30 | 180.30 | 189 | 196.6 | 208.30 | 214.70 |
| WPI Inflation (%) | 3.92 | 6.49 | 4.29 | 4.83 | 2.91 | 5.95 | 3.07 |

Source: RBI Bulletin, October 2007; WSS: October 26, 2007; \$\$1993=94=100, year/month-end; @ October 06, 2006; @@ October 06, 2007



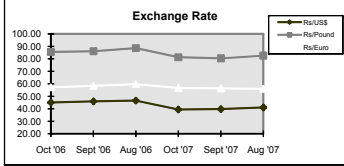
| During the Year | 2001-02 | 2002-03 | 2003-04 | 2004-05 | 2005-06 | 2006-07 | April-Sept. 2007 |
|-------------------------------|---------|---------|----------|----------|----------|----------|------------------|
| Exports (US \$ Million) | 43,827 | 52,719 | 63,843 | 83,536 | 103,061 | 124,629 | 72,281 |
| Imports (US \$ Million) | 51,413 | 61,412 | 78,149 | 111,517 | 143,433 | 181,368 | 109,204 |
| Trade Balance (US \$ Million) | (7,586) | (8,693) | (14,306) | (27,981) | (40,372) | (56,739) | (36,923) |

Source: RBI Bulletin, September 2007; Revised figures for 2001-02 to 2006-07 (April-March)
*DGI&S data for April 2006 to March 2007 (Provisional)



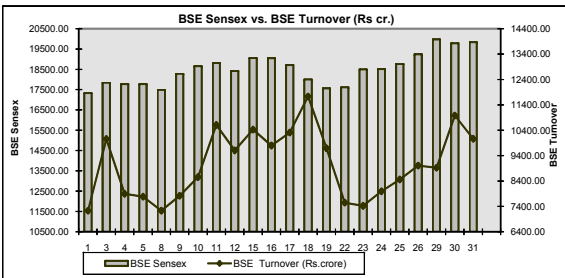
| | 2006-07 (US\$ million) | | | 2007-08 (US\$ million) | | |
|----------|------------------------|----------|----------|------------------------|-----------|-----------|
| | Oct '06 | Sept '06 | Aug '06 | Oct '07 | Sept '07 | Aug '07 |
| FII Net | 1,378.5 | 1,318.2 | 1,172.6 | 5,683.5 | 4,608.6 | (1,542.4) |
| FII Cum. | 48,806.8 | 46,028.5 | 45,610.6 | 69,316.80 | 63,633.50 | 59,254.50 |

Source: SEBI - Diff. in total figures are due to rounding off.



| | 2006-07 | | | 2007-08 | | |
|----------|---------|----------|---------|---------|----------|---------|
| | Oct '06 | Sept '06 | Aug '06 | Oct '07 | Sept '07 | Aug '07 |
| Ru/US\$ | 45.02 | 45.96 | 46.55 | 39.35 | 39.74 | 40.96 |
| Ru/Pound | 85.56 | 86.09 | 88.72 | 81.35 | 80.34 | 82.55 |
| Ru/Euro | 57.24 | 58.33 | 59.71 | 56.75 | 56.30 | 55.96 |

Figures are for month-end



| October 2007 | BSE Sensex Close | BSE Turnover (Rs.crore) |
|---------------|------------------|-------------------------|
| Sept 28, 2007 | 17291.10 | 7951.00 |
| 1 | 17328.52 | 7229.00 |
| 3 | 17847.04 | 10055.00 |
| 4 | 17777.14 | 7892.00 |
| 5 | 17773.36 | 7779.00 |
| 8 | 17491.39 | 7229.00 |
| 9 | 18280.24 | 7816.00 |
| 10 | 18658.25 | 8354.00 |
| 11 | 18814.07 | 10604.00 |
| 12 | 18419.04 | 9603.00 |
| 15 | 19055.67 | 10424.00 |
| 16 | 19051.86 | 9794.00 |
| 17 | 18715.82 | 10308.00 |
| 18 | 17998.39 | 11732.00 |
| 19 | 17559.98 | 9688.00 |
| 22 | 17613.99 | 7546.00 |
| 23 | 18492.84 | 7418.00 |
| 24 | 18512.91 | 7997.00 |
| 25 | 18770.89 | 8457.00 |
| 26 | 19243.17 | 9005.00 |
| 29 | 19977.67 | 8921.00 |
| 30 | 19783.51 | 10981.00 |
| 31 | 19837.99 | 10060.00 |



Annexure 1 : Select International Economic Indicators for Developed Industrialised Countries And India

| Country | Interest rates, (%) | | CPI (percentage change) | | Currency unit per US \$ | | Union Budget (+) / (-) % of GDP 2007 | Real Rate (Short-term) (1-3) | Currency unit per Euro 31.10.07 | Balance Latest :12 months | | Col 11 as Percentage of GDP 2007 |
|-------------|---------------------|-------------------------------|-------------------------|---------------|-------------------------|---------------|--|------------------------------------|---------------------------------------|----------------------------|------------------------------|--|
| | 3-month latest | 10-year gov't bonds latest | Latest | A Year ago | As on 31.10.07 | A Year ago | | | | Trade Account (US\$ bn) | Current Account (US\$ bn) | |
| | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 |
| Euro-11 | 4.60 | 4.24 | 2.60 | 1.60 | 0.69 | 0.78 | -0.90 | 2.00 | 1.00 | 42.1 | 30.4 | 0.2 |
| | | | Oct | | | | | | | Aug | Aug | |
| U. S. A. | 4.51 | 4.47 | 2.80 | 2.10 | 1.00 | 1.00 | -1.50 | 1.71 | 1.45 | -810.7 | -793.20 | -5.6 |
| | | | Sept | | | | | | | Aug | Q2 | |
| Britain | 6.22 | 4.97 | 1.80 | 2.40 | 0.48 | 0.52 | -3.00 | 4.42 | 0.70 | -160.4 | -86.60 | -3.2 |
| | | | Sept | | | | | | | Aug | Q2 | |
| Japan | 0.73 | 1.60 | -0.2 | 0.60 | 115.00 | 117.00 | -2.60 | 0.93 | 166.67 | 98.1 | 197.50 | 4.6 |
| | | | Sept | | | | | | | Aug | Aug | |
| Sweden | 3.88 | 4.25 | 2.20 | 1.50 | 6.36 | 7.20 | 2.80 | 1.68 | 9.22 | 16.3 | 29.70 | 6.9 |
| | | | Sept | | | | | | | Aug | Q2 | |
| Switzerland | 2.75 | 2.92 | 0.70 | 0.80 | 1.16 | 1.24 | 0.30 | 2.05 | 1.68 | 11.1 | 64.80 | 16.4 |
| | | | Sept | | | | | | | Aug | Q2 | |
| India | 7.00 | 8.19 | 7.30 | 6.30 | 39.30 | 44.90 | -3.30 | -0.30 | 56.96 | -65.4 | -9.70 | -1.6 |
| | | | Aug | | | | | | | Sept | Q2 | |

Source: The Economist London: November 3rd - 9th, 2007
**RPI Inflation rate 3.8% in July

Figures in Column 9 are derived.

Annexure 2 : Important Economic Indicators for Select Emerging Market Countries

| Country | Interest rates, (%) | | CPI (percentage change) | | Currency unit per US \$ | | Union Budget (+) / (-) % of GDP 2007 | Real Rate (Short-term) (1-3) | Currency unit per Euro 31.10.07 | Balance Latest :12 months | | Col 11 as Percentage of GDP 2007 |
|-------------|---------------------|-------------------------------|-------------------------|---------------|-------------------------|---------------|--|------------------------------------|---------------------------------------|----------------------------|------------------------------|--|
| | 3-month latest | 10-year gov't bonds latest | Latest | A Year ago | As on 31.10.07 | A Year ago | | | | Trade Account (US\$ bn) | Current Account (US\$ bn) | |
| | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 |
| China | 4.05 | 4.89 | 6.2 | 1.5 | 7.46 | 7.87 | 0.2 | -2.15 | 10.81 | 253.4 | 249.9 | 10.7 |
| | | | Sept | | | | | | | Sept | 2006 | |
| Hongkong | 4.68 | 3.72 | 1.6 | 2.1 | 7.75 | 7.78 | 1.9 | 3.08 | 11.23 | -20.6 | 24.9 | 9.8 |
| | | | Sept | | | | | | | Aug | Q2 | |
| Indonesia | 8.09 | 6.34 | 6.9 | 6.3 | 9097.00 | 9103.00 | -1.7 | 1.19 | 13184.06 | 41.7 | 11.0 | 2.4 |
| | | | Oct | | | | | | | Aug | Q2 | |
| Malaysia | 3.62 | 4.78 | 1.8 | 3.3 | 3.34 | 3.65 | -3.2 | 1.82 | 4.84 | 28.7 | 27.6 | 13.8 |
| | | | Sept | | | | | | | Aug | Q2 | |
| Singapore | 2.50 | 2.81 | 2.7 | 0.4 | 1.45 | 1.56 | 0.30 | -0.20 | 2.10 | 38.5 | 41.6 | 27.4 |
| | | | Sept | | | | | | | Sept | Q2 | |
| South Korea | 5.34 | 5.48 | 3.0 | 2.2 | 901.00 | 939.00 | 0.4 | 2.34 | 1305.80 | 19.7 | 8.1 | 0.4 |
| | | | Oct | | | | | | | Oct | Aug | |
| Taiwan | 2.60 | 2.77 | 3.1 | -1.2 | 32.40 | 33.20 | -2.0 | -0.50 | 46.96 | 14.6 | 28.3 | 6.4 |
| | | | Sept | | | | | | | Sept | Q2 | |
| Thailand | 3.55 | 4.38 | 2.5 | 2.8 | 34.00 | 36.70 | -1.9 | 1.05 | 49.28 | 10.7 | 10.9 | 3.6 |
| | | | Oct | | | | | | | Sept | Aug | |
| Brazil | 11.17 | 6.16 | 4.1 | 3.7 | 1.74 | 2.14 | -1.8 | 7.07 | 2.52 | 43.1 | 9.0 | 0.7 |
| | | | Sept | | | | | | | Sept | Sept | |
| Venezuela | 11.05 | 6.55 | 15.3 | 15.3 | 2147.00 | 2959.00 | -2.6 | -4.25 | 3111.59 | 23.8 | 20.4 | 7.2 |
| | | | Sept | | | | | | | Q2 | Q2 | |
| India | 7.00 | 8.19 | 7.30 | 6.30 | 39.30 | 44.90 | -3.3 | -0.30 | 56.96 | -65.4 | -9.7 | -1.6 |
| | | | Aug | | | | | | | Sept | Q2 | |

Source: The Economist London: November 3rd - 9th, 2007

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