THE WORLD IS NO LONGER FLAT

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Global economy bouncing to malaise

- A powerful synchronized global upturn as inventory and durables rebound and trade normalizes

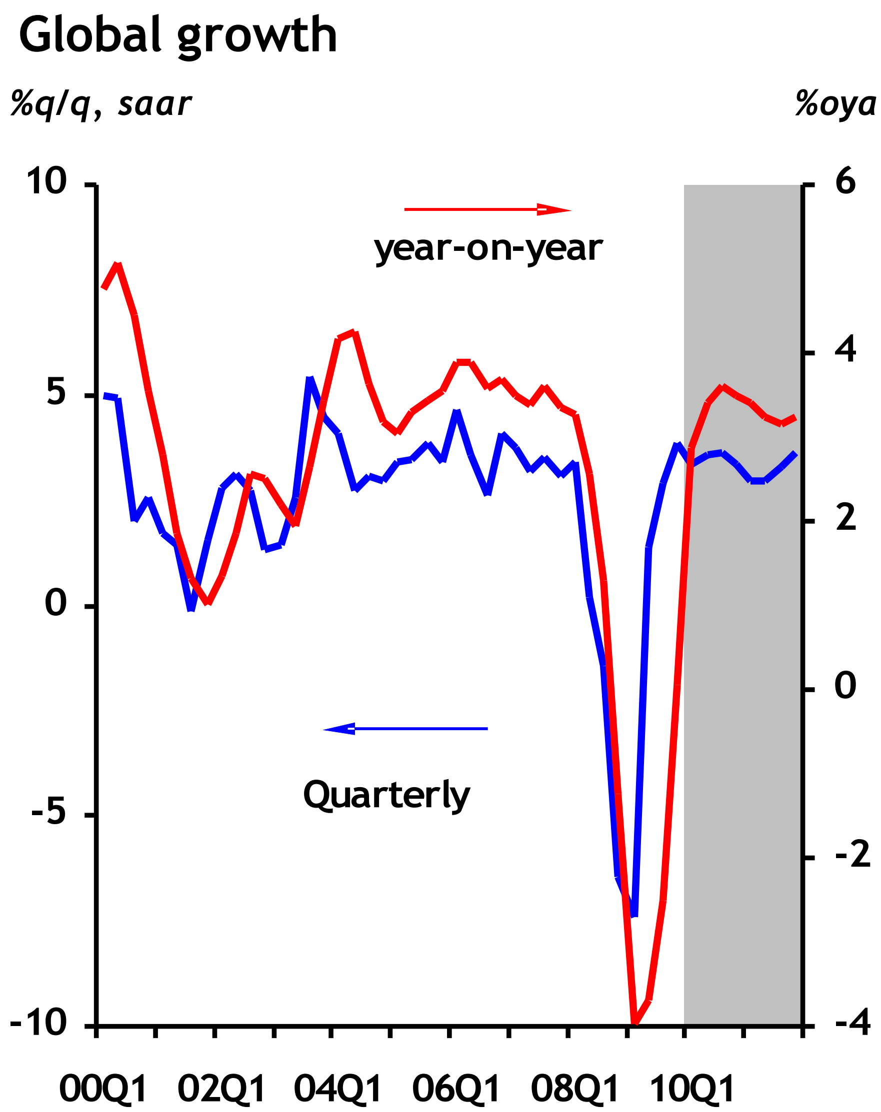
- Growth sustainability depends on:

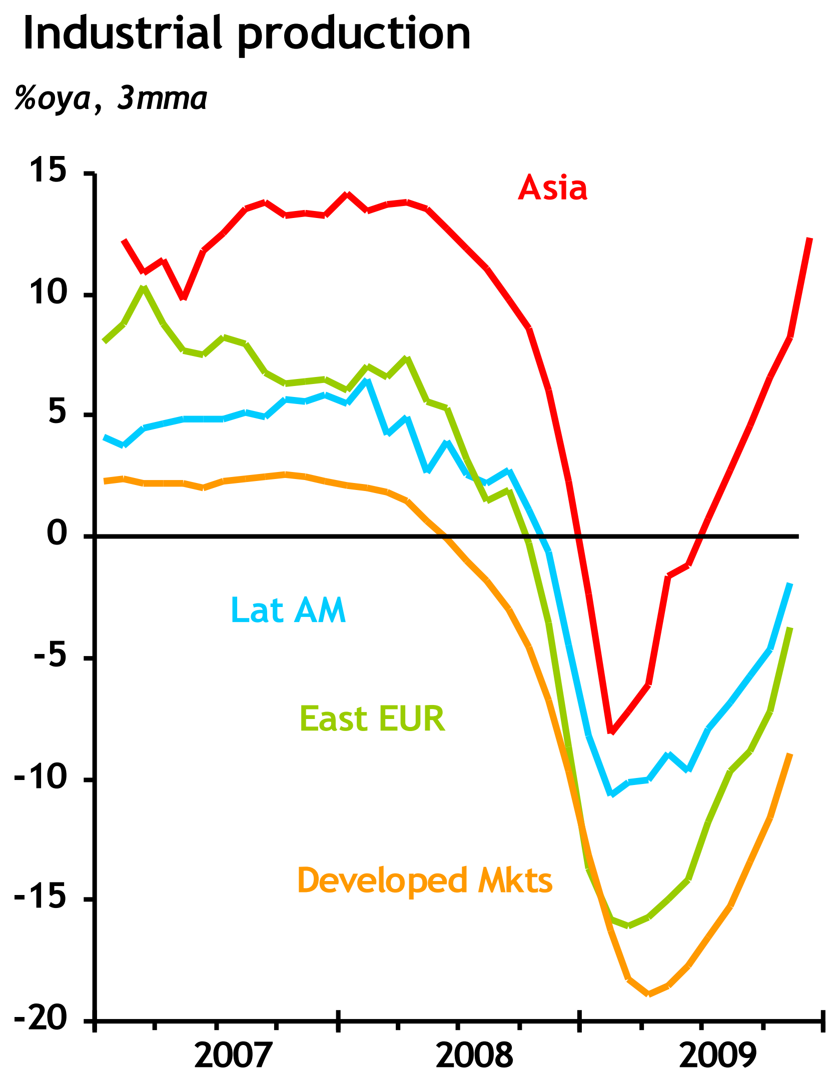
  - firm and household behaviour shifting from retrenchment to expansion

  - managing the permanent decline in DM potential GDP

  - withstanding prolonged fiscal headwind

Global IP surges

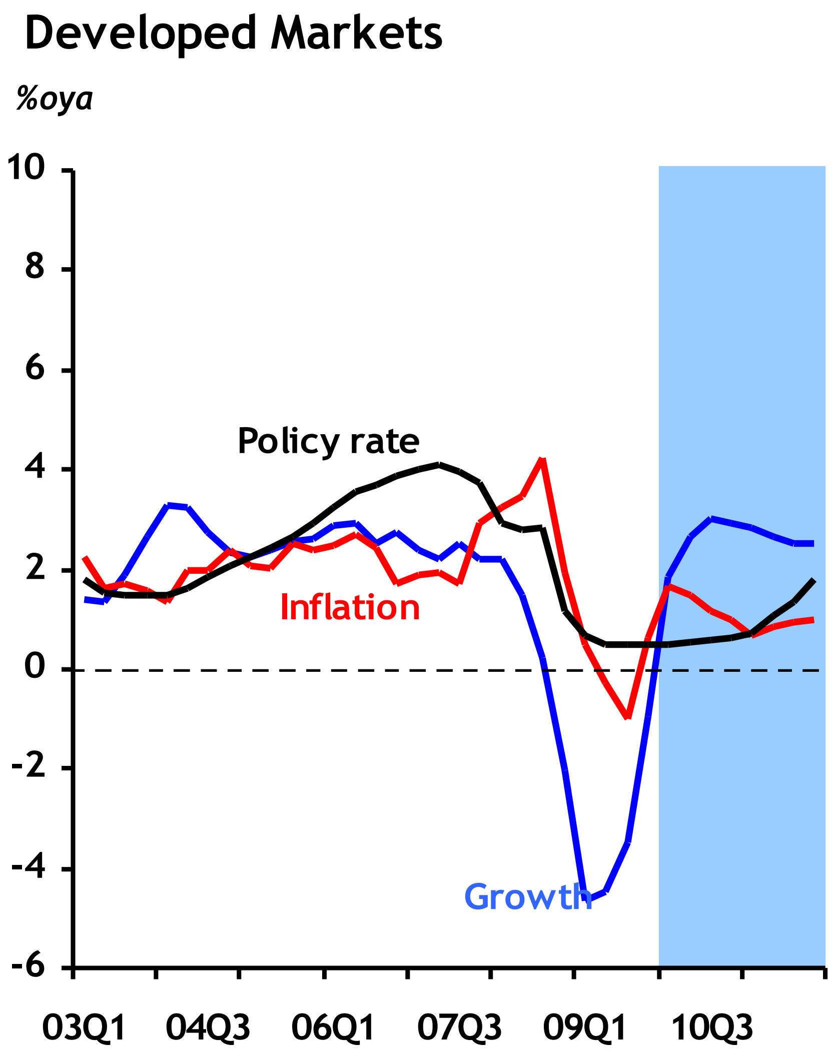


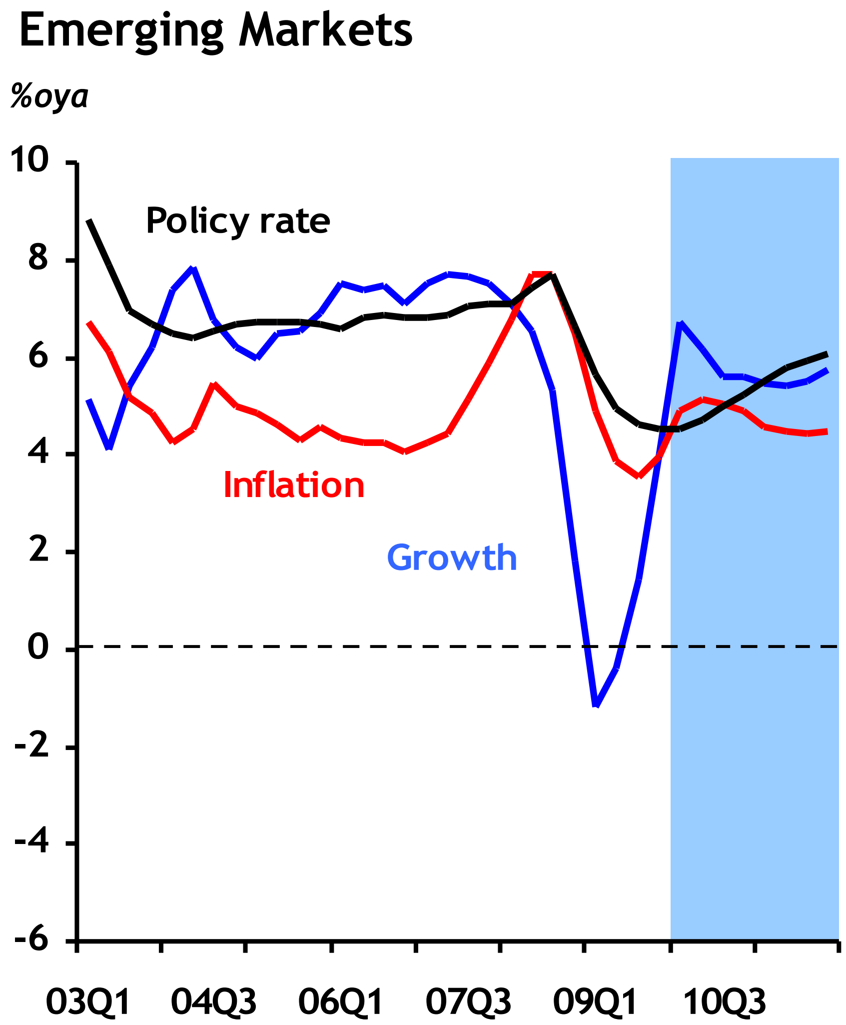


And trade recovers

Global PMI export orders

Global risk I: premature tightening

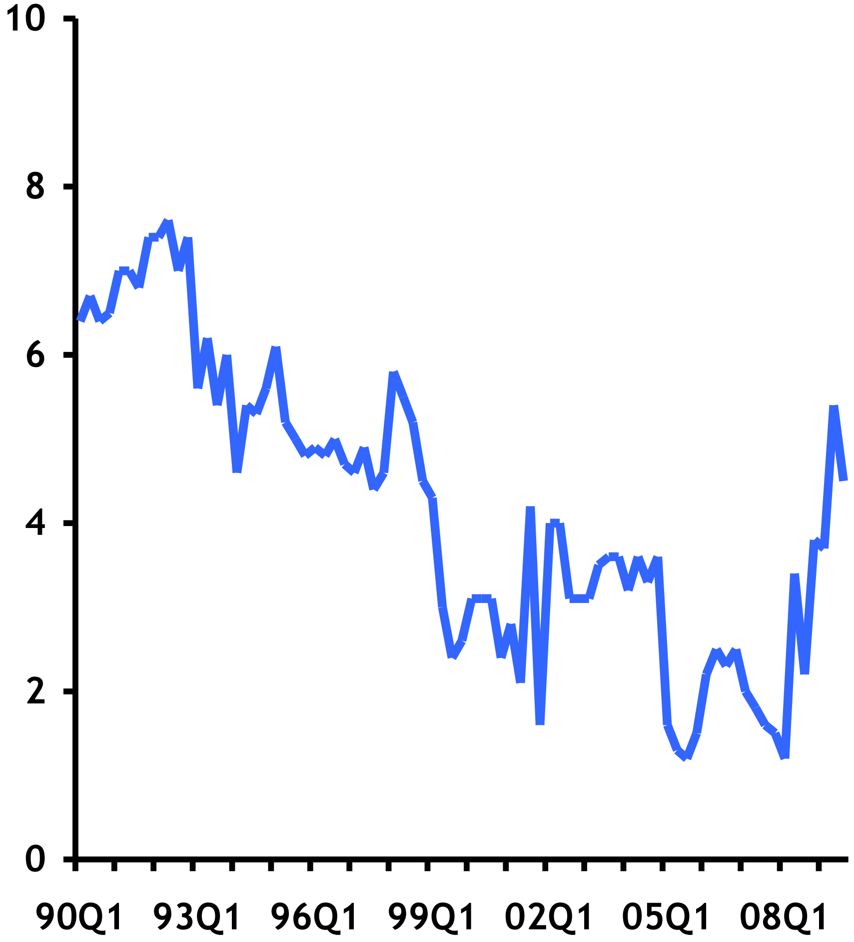




Global risk II: DM saving keeps rising

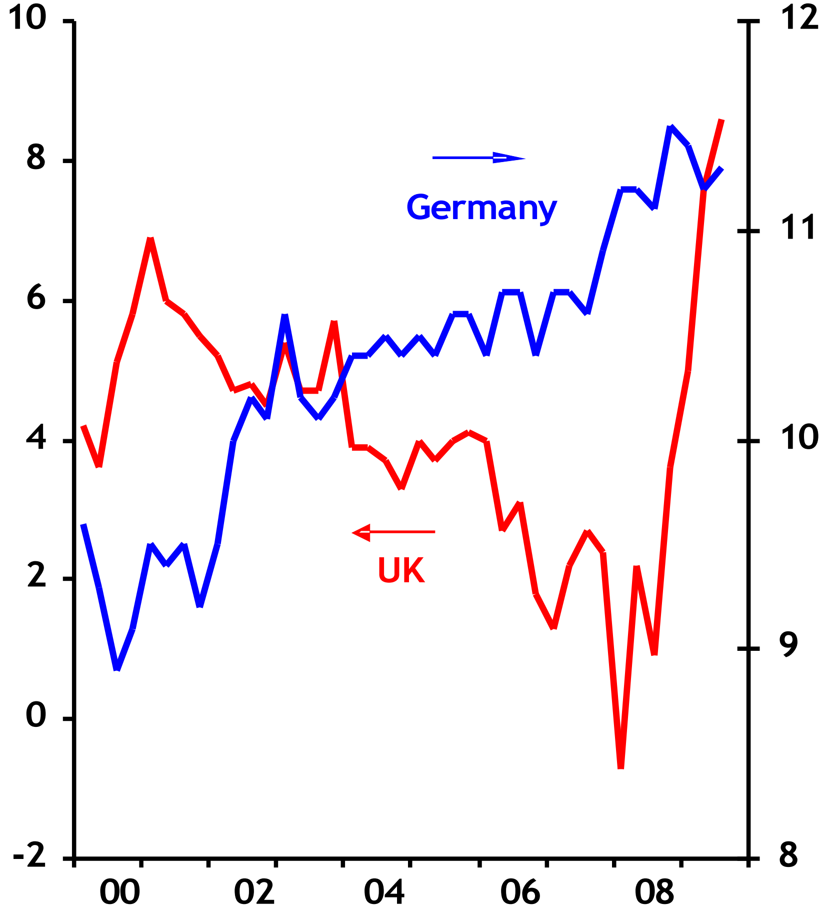
US personal saving rate

% of disposable income, sa



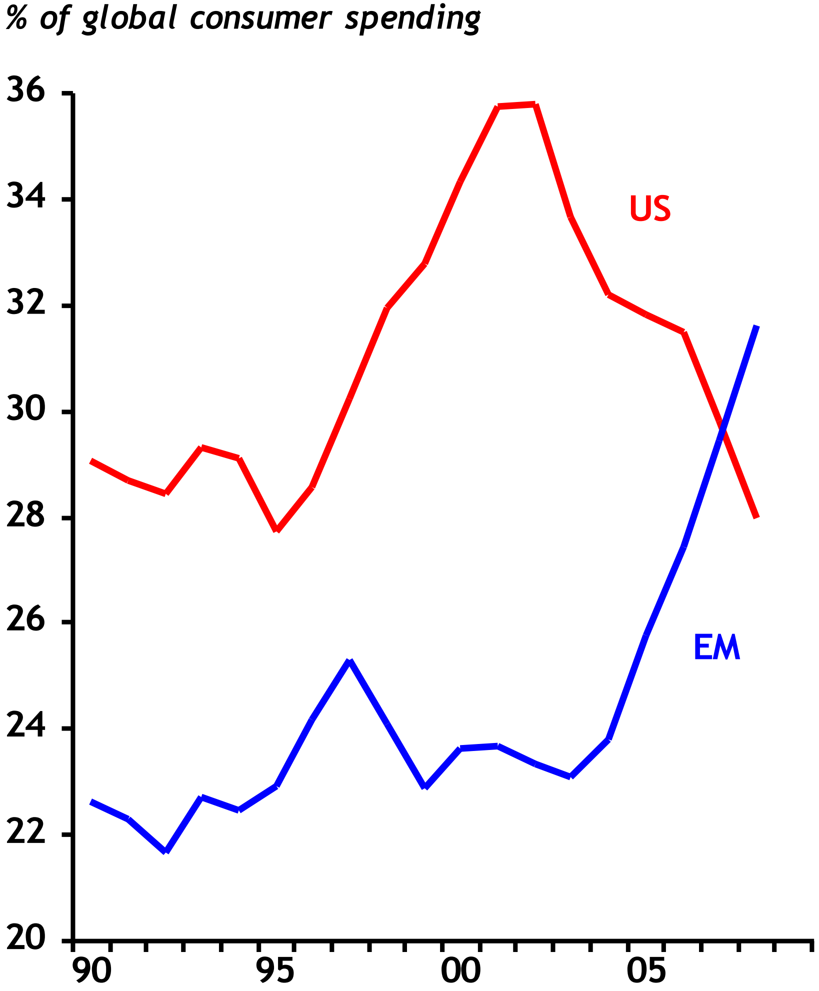
Households saving rate

percent, sa

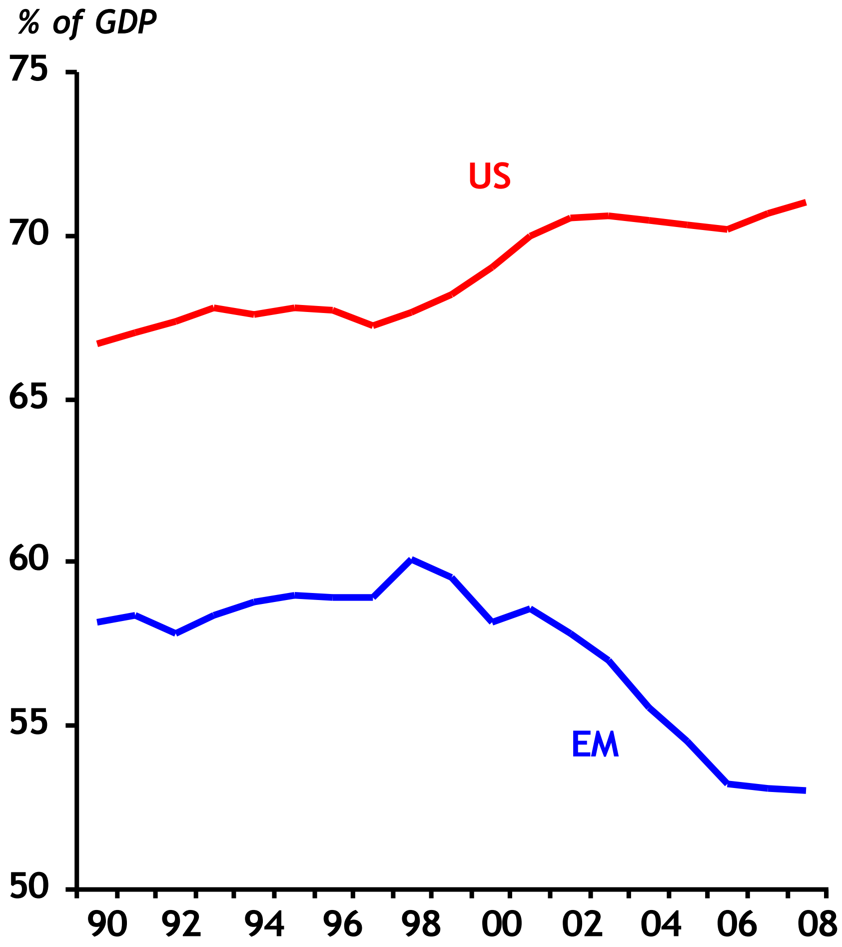


Should we be comforted …

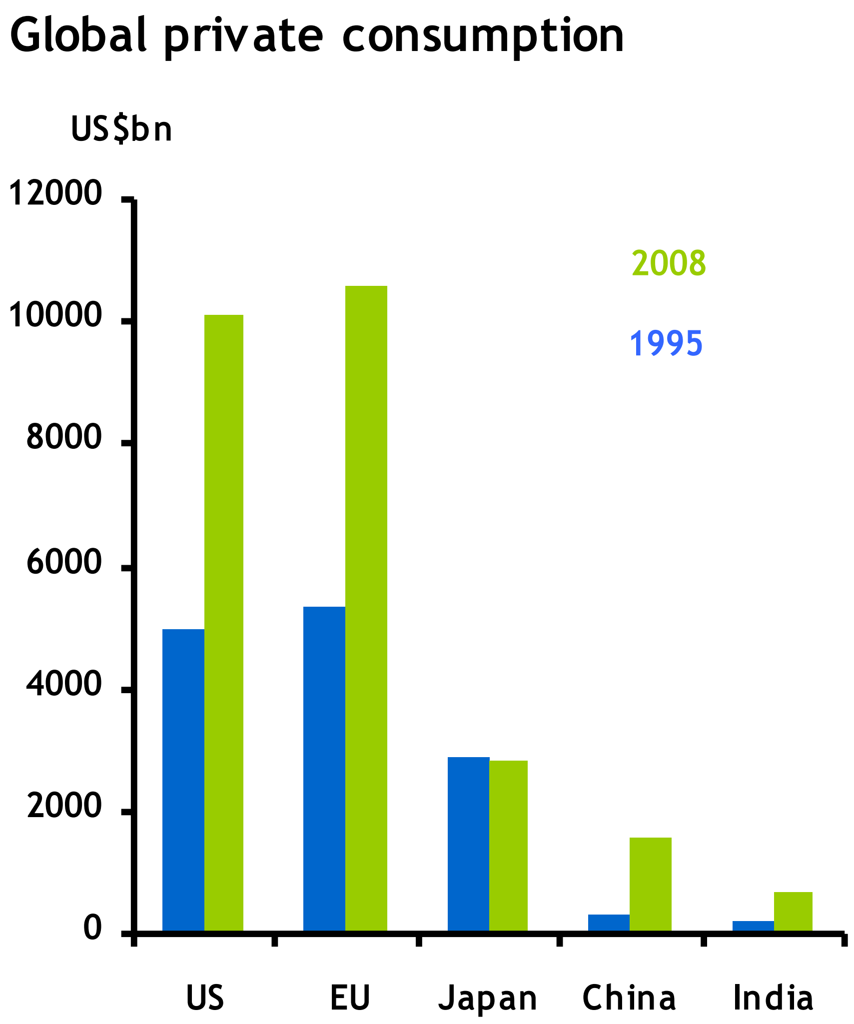
EM consumes more than the US now

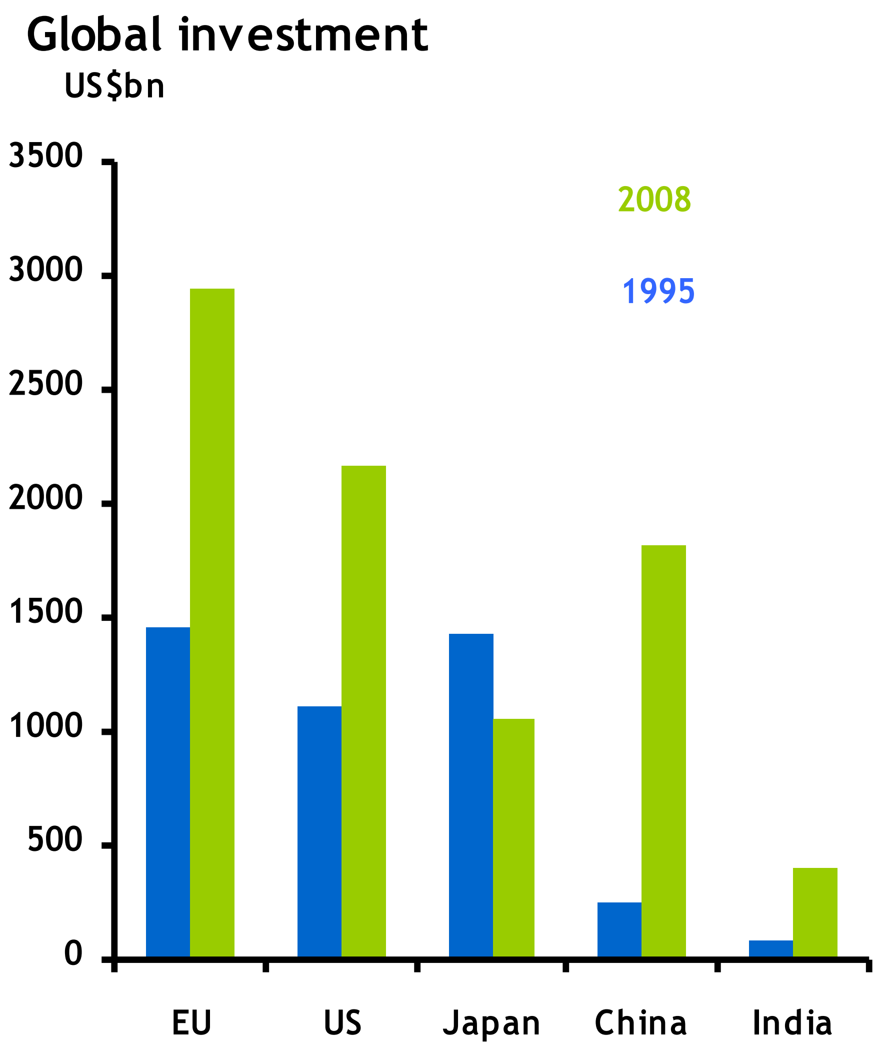


With lower consumption propensity



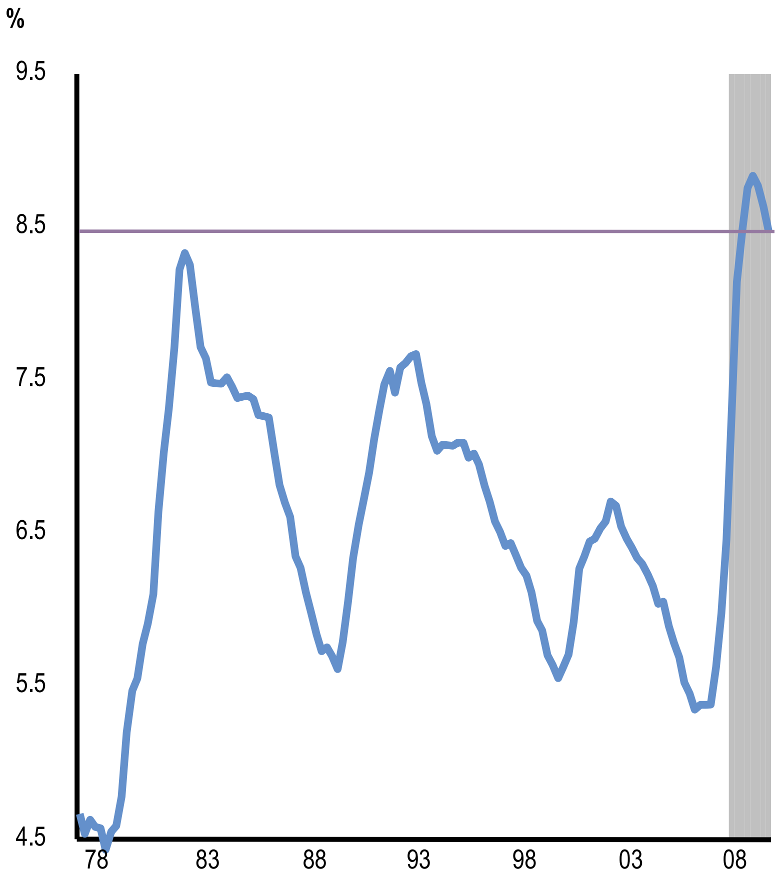
… or concerned?



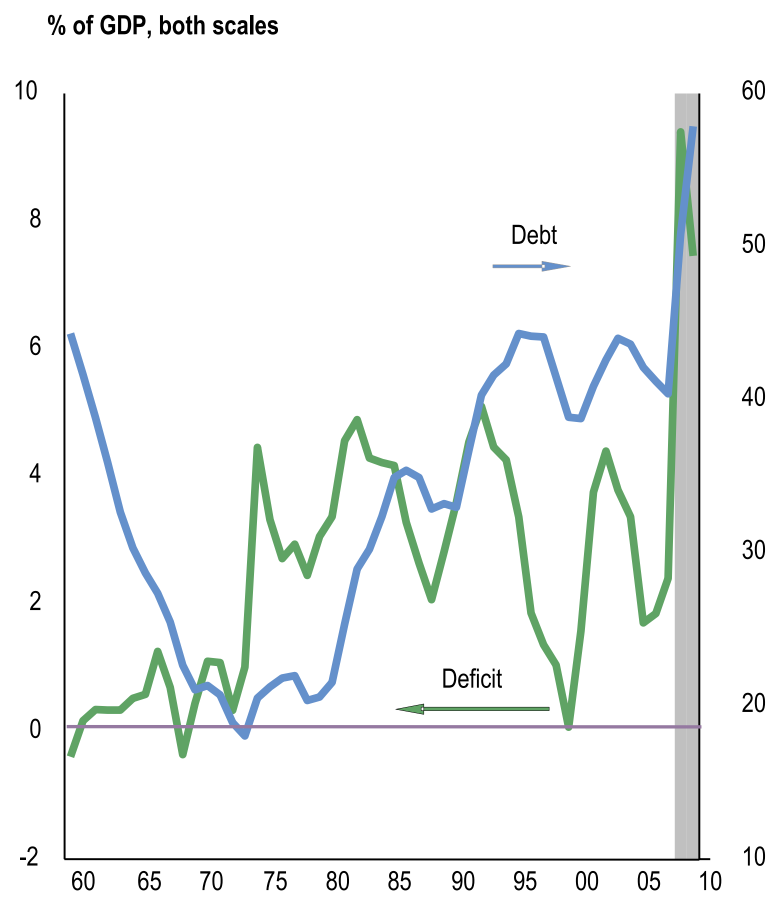


Global risk III: Fiscal headwind and social cost of unemployment rising

Developed world unemployment rates



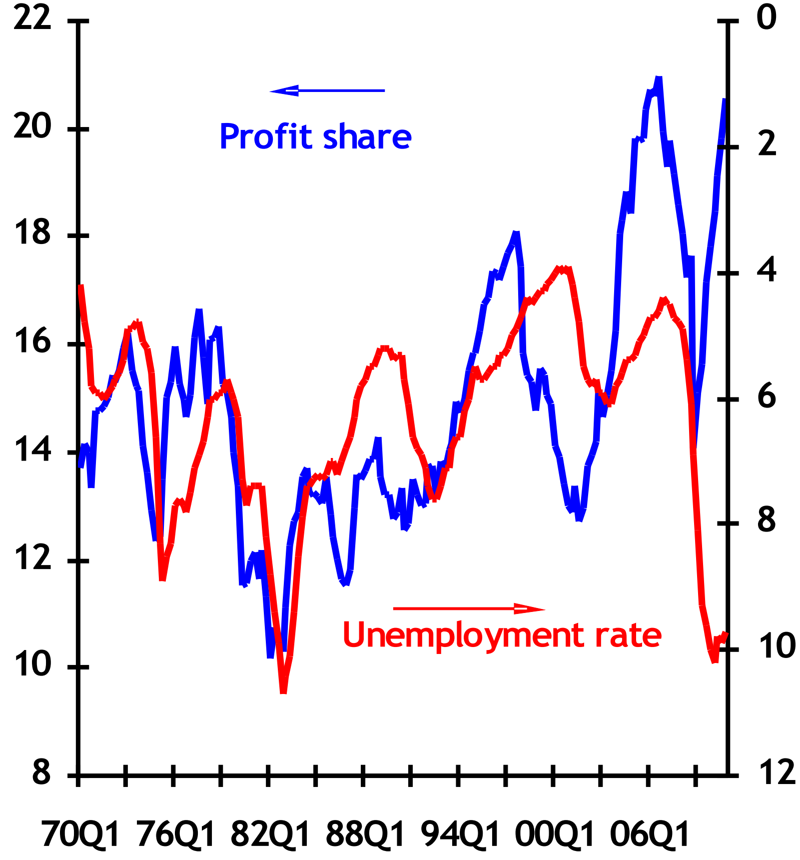
DM fiscal deficits and debt



Global risk III: Profit margins have surged, wages haven't

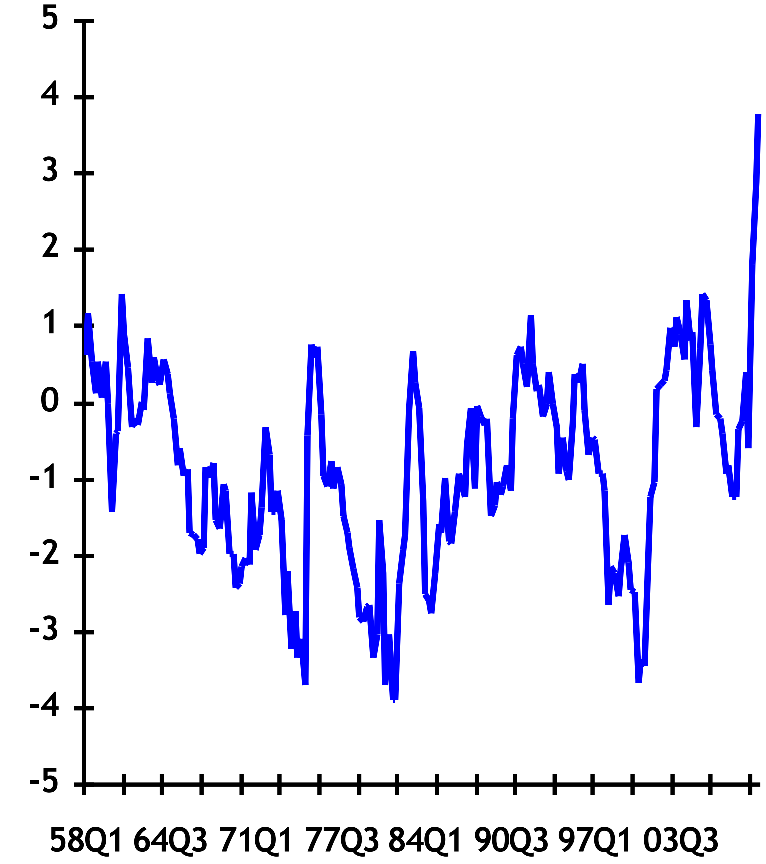
US corporate profit margins and unemployment rate

% of gross value added, forecast through 2010

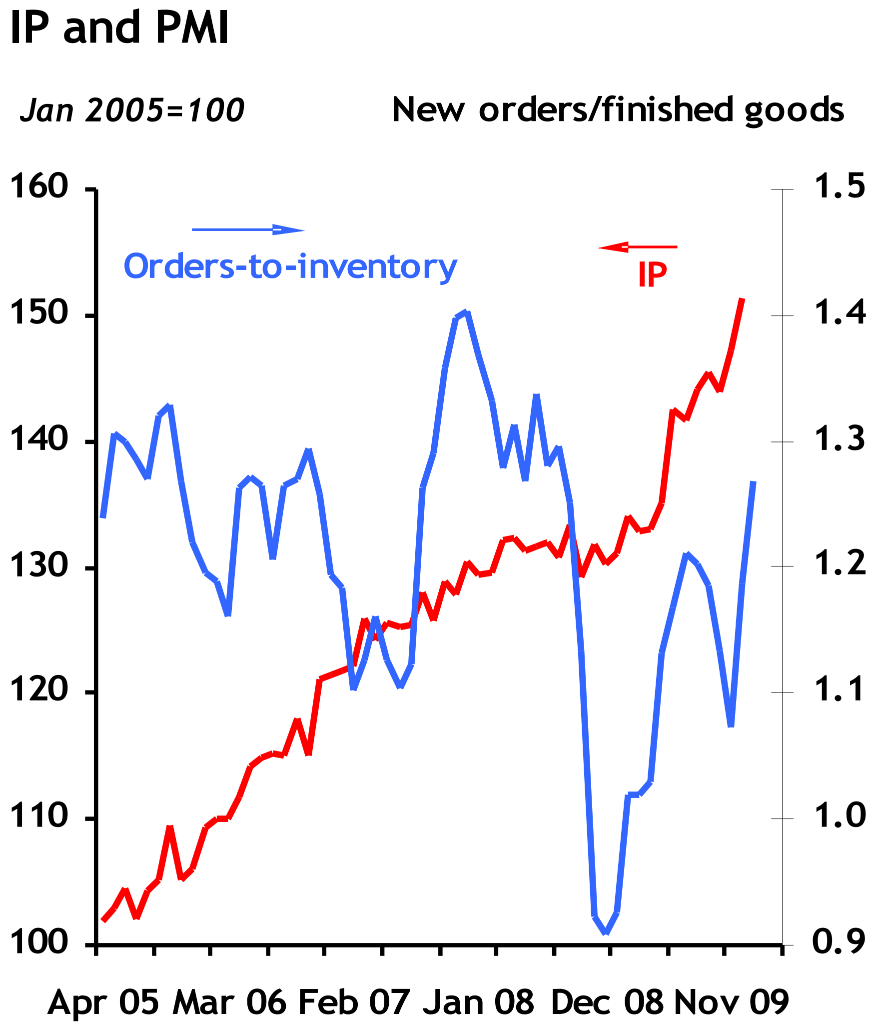


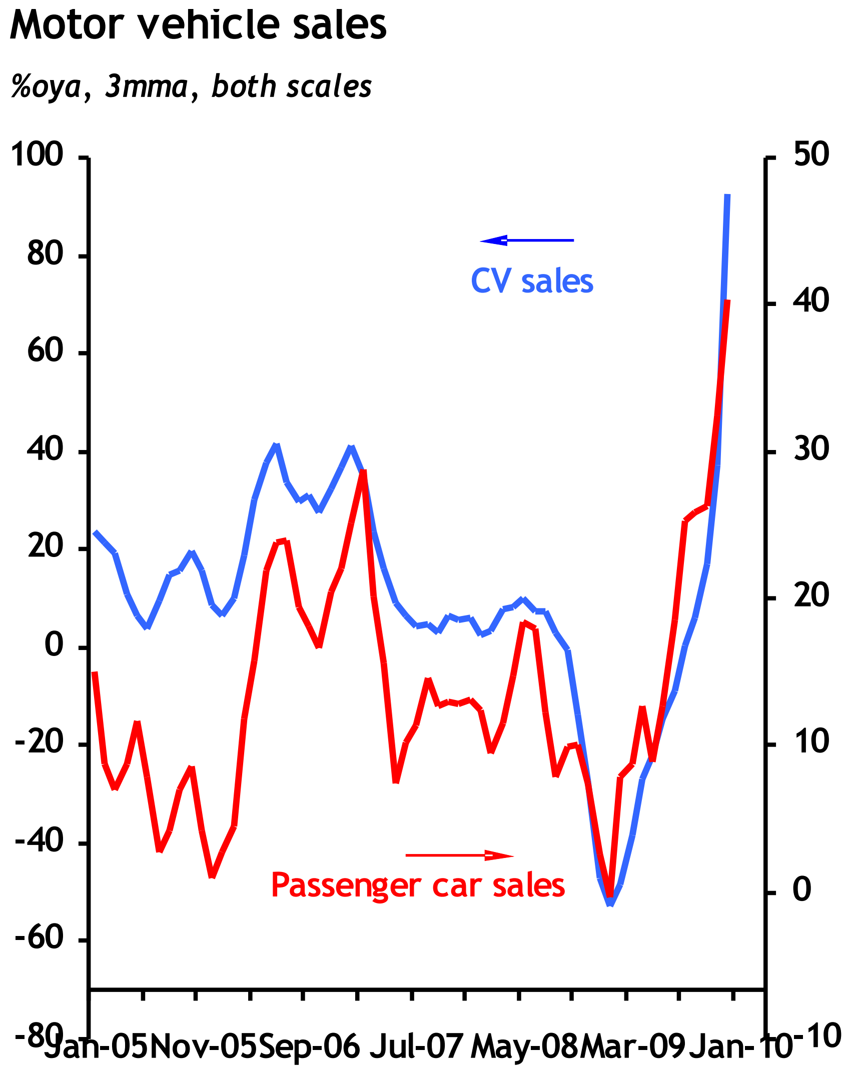
US net financial position

% of GDP



India turns hot as demand indicators surge

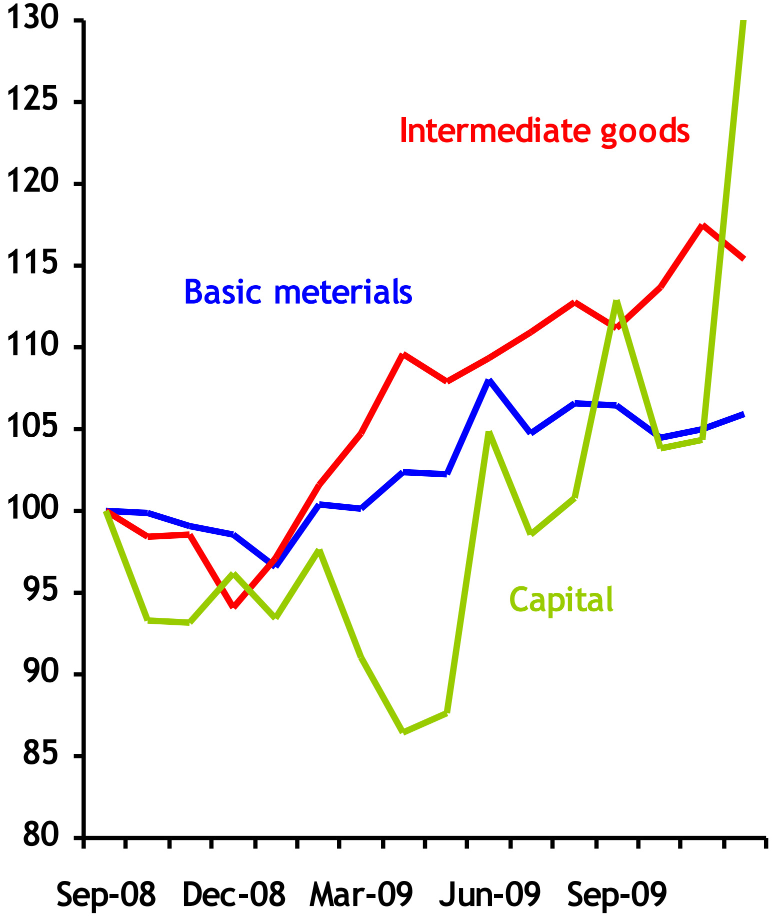




Capacity may begin to get constrained

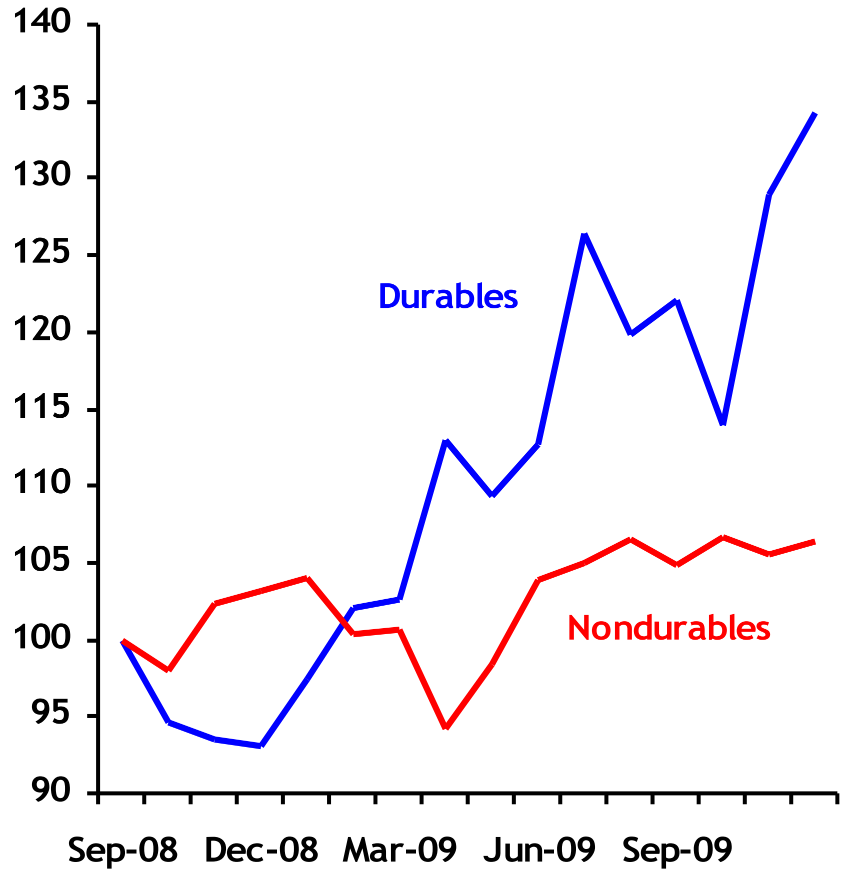
Capital goods drive the strength

Index sa, Sep 2008=100

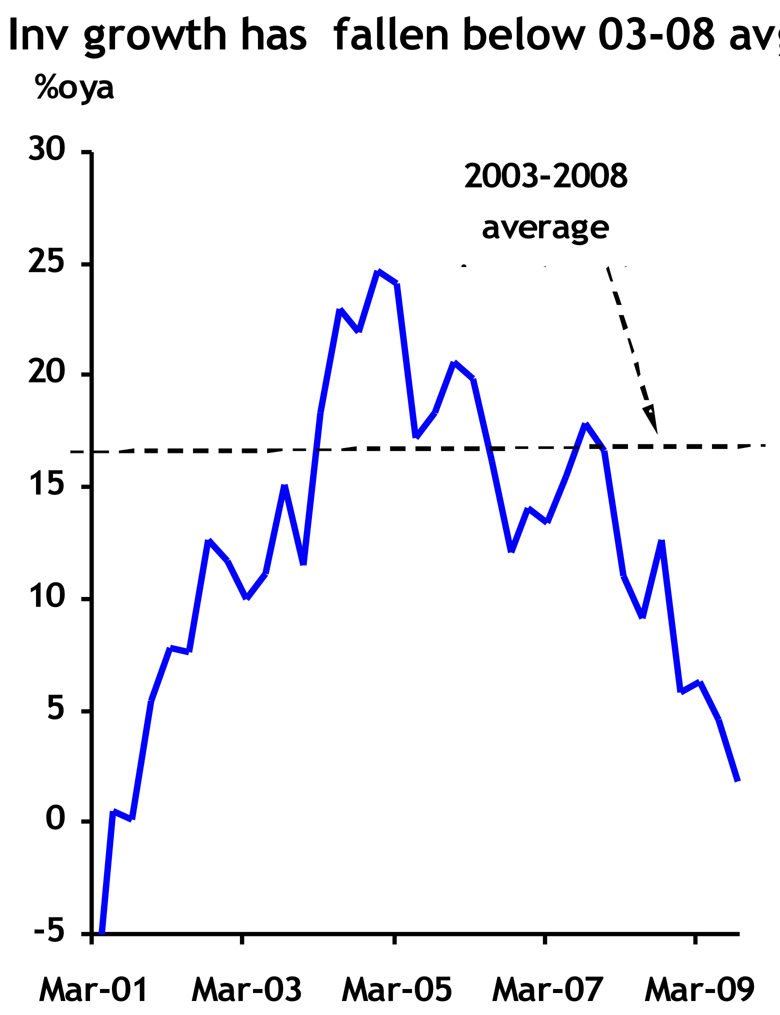


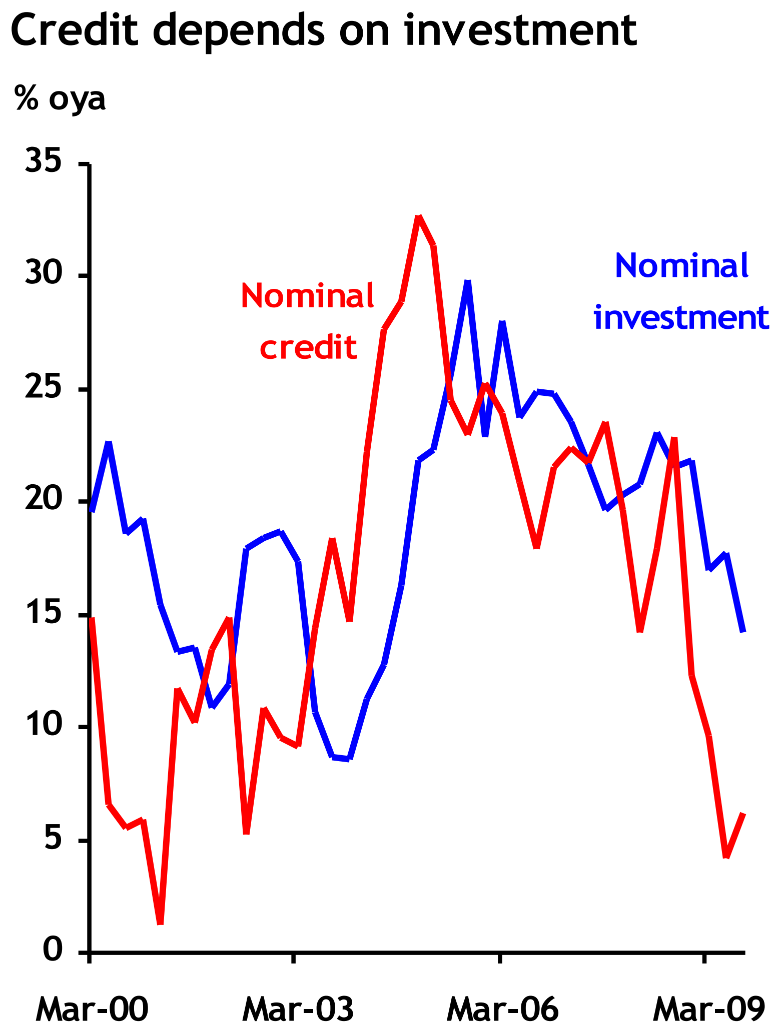
Durables gain on motor vehicle sales

Index sa, Sep 2008=100



Credit languishes as investment is flat

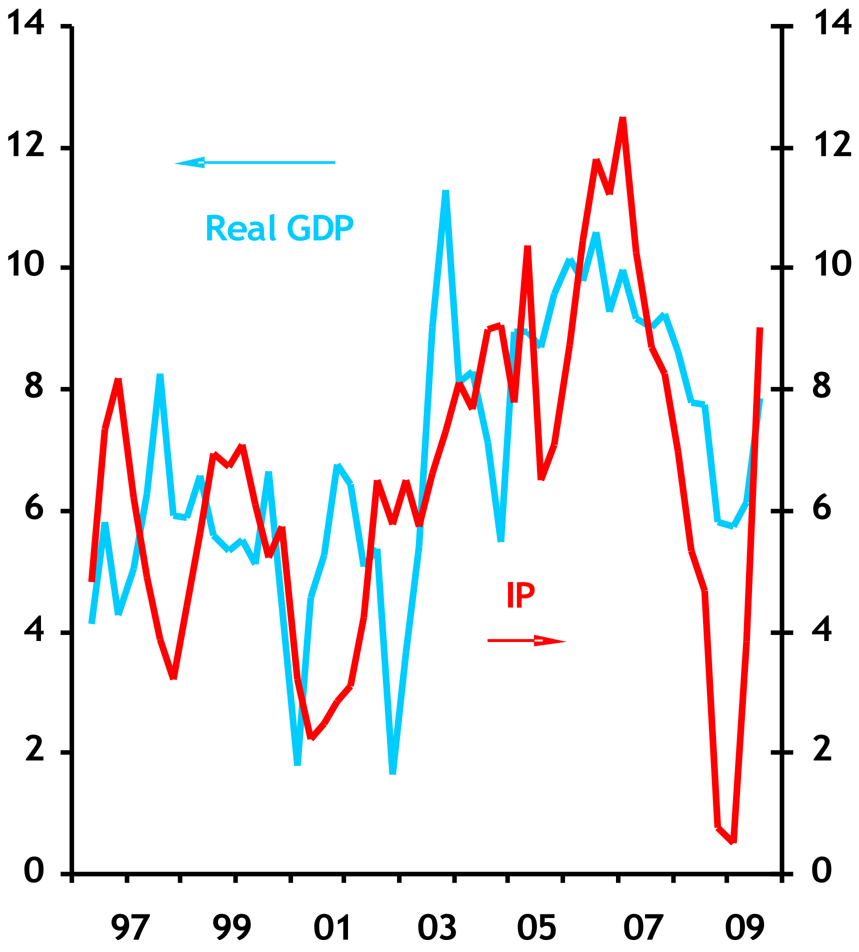




A lot depends on the global economy for IP, growth,

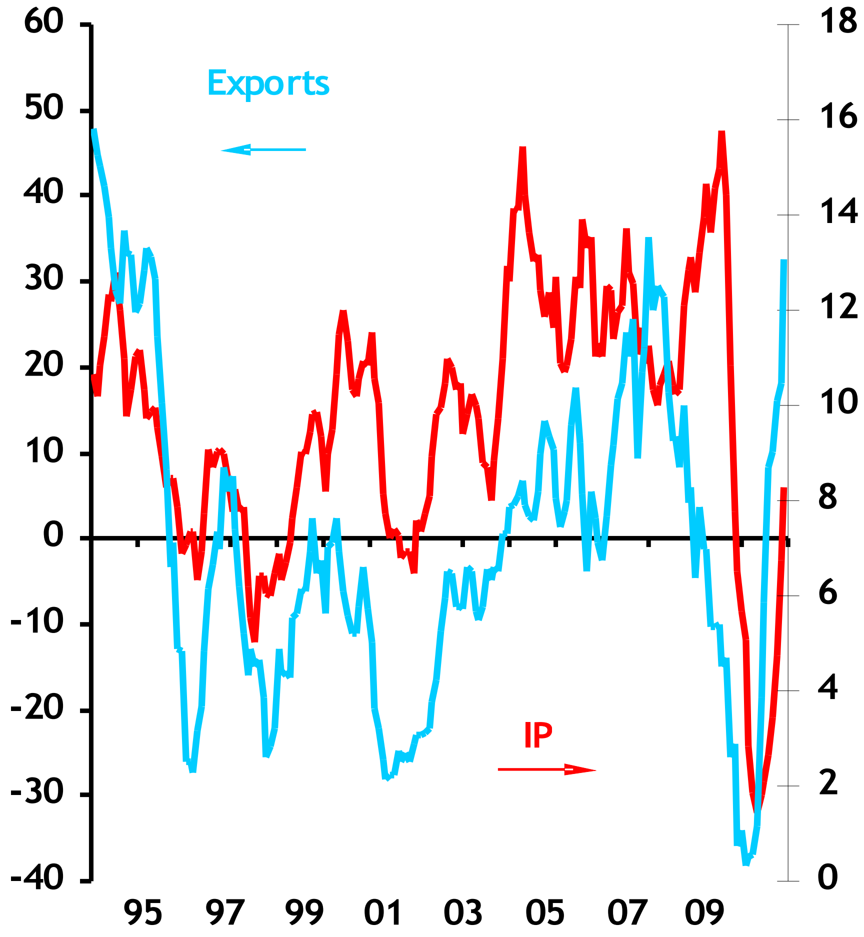
GDP and IP

%oya

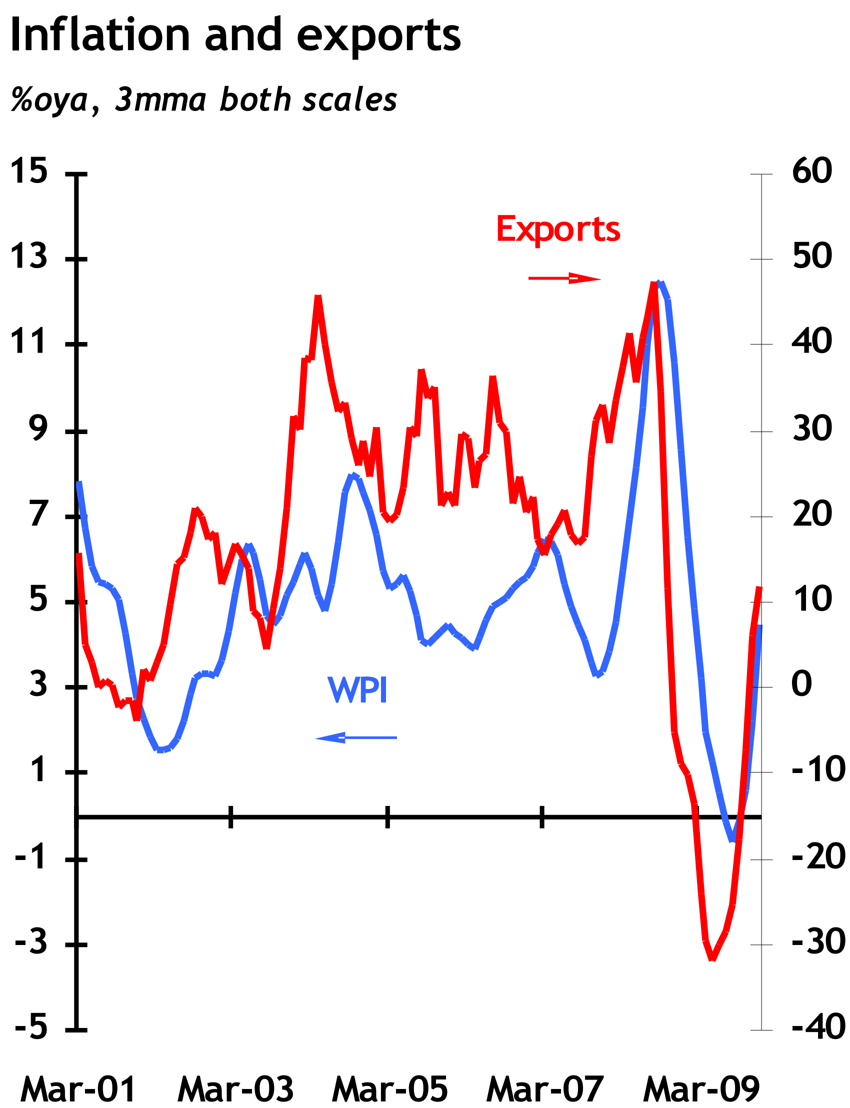


IP and exports

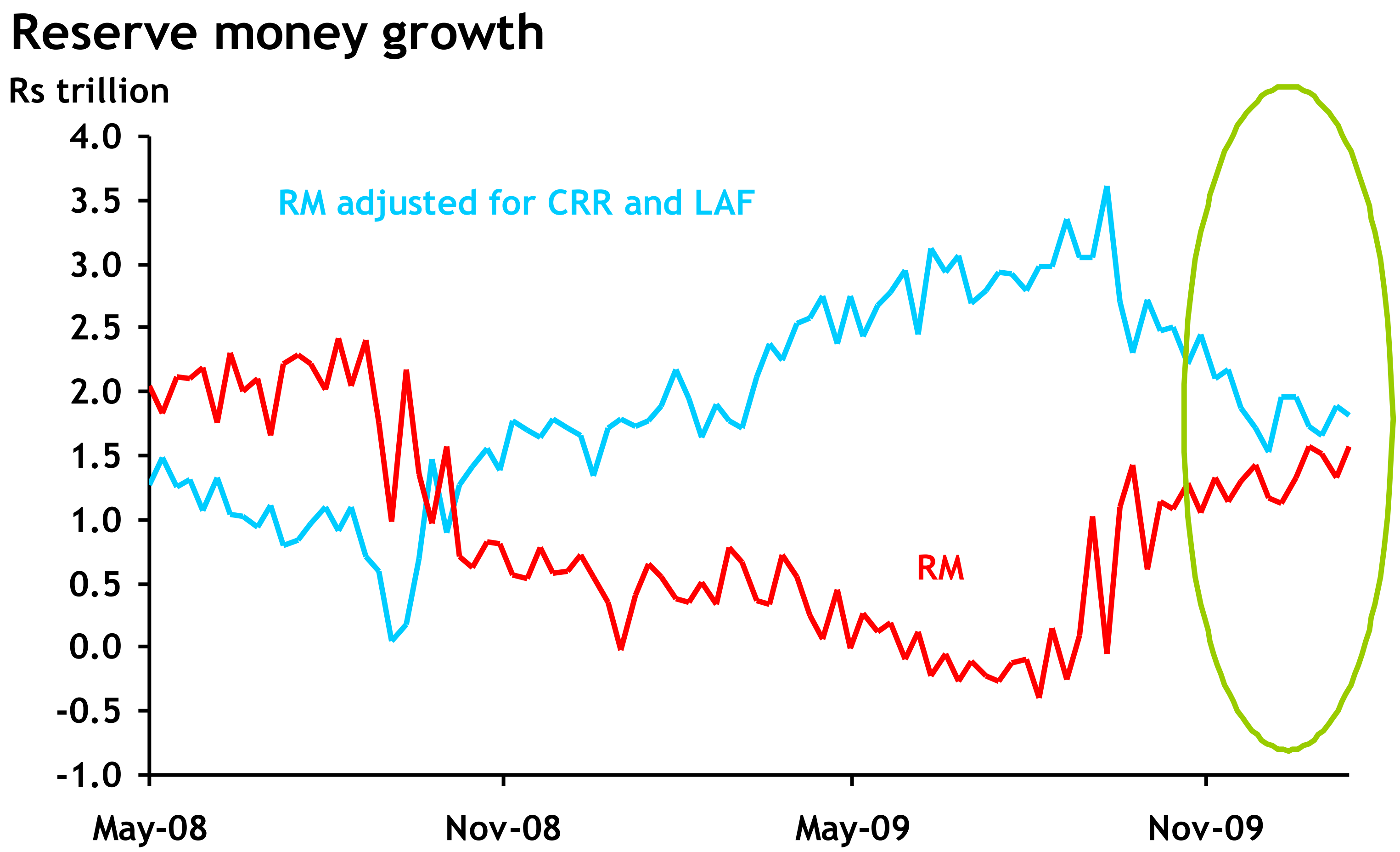
%oya, 3mma, both scales



… and even inflation



Monetary tightening started earlier than January



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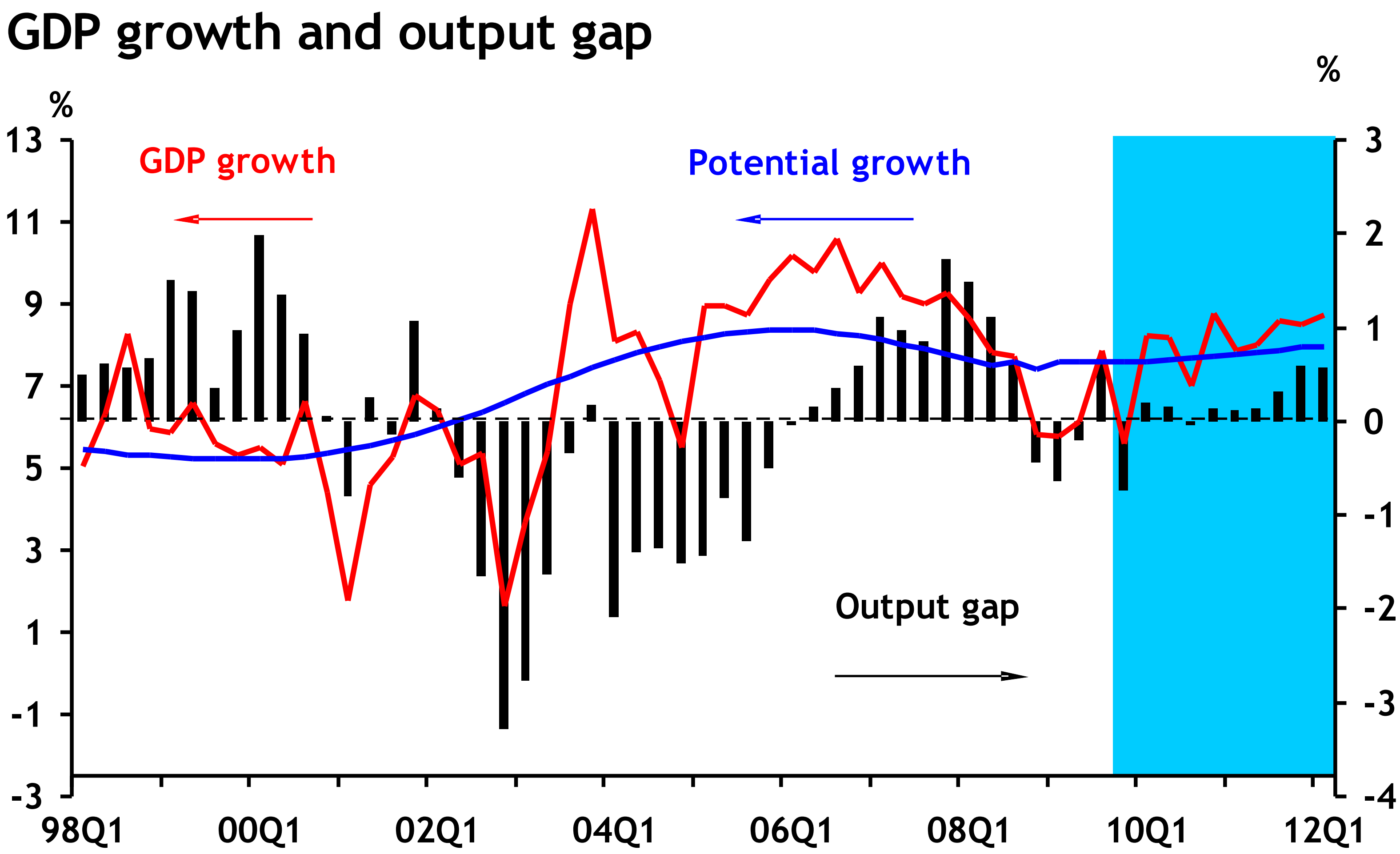
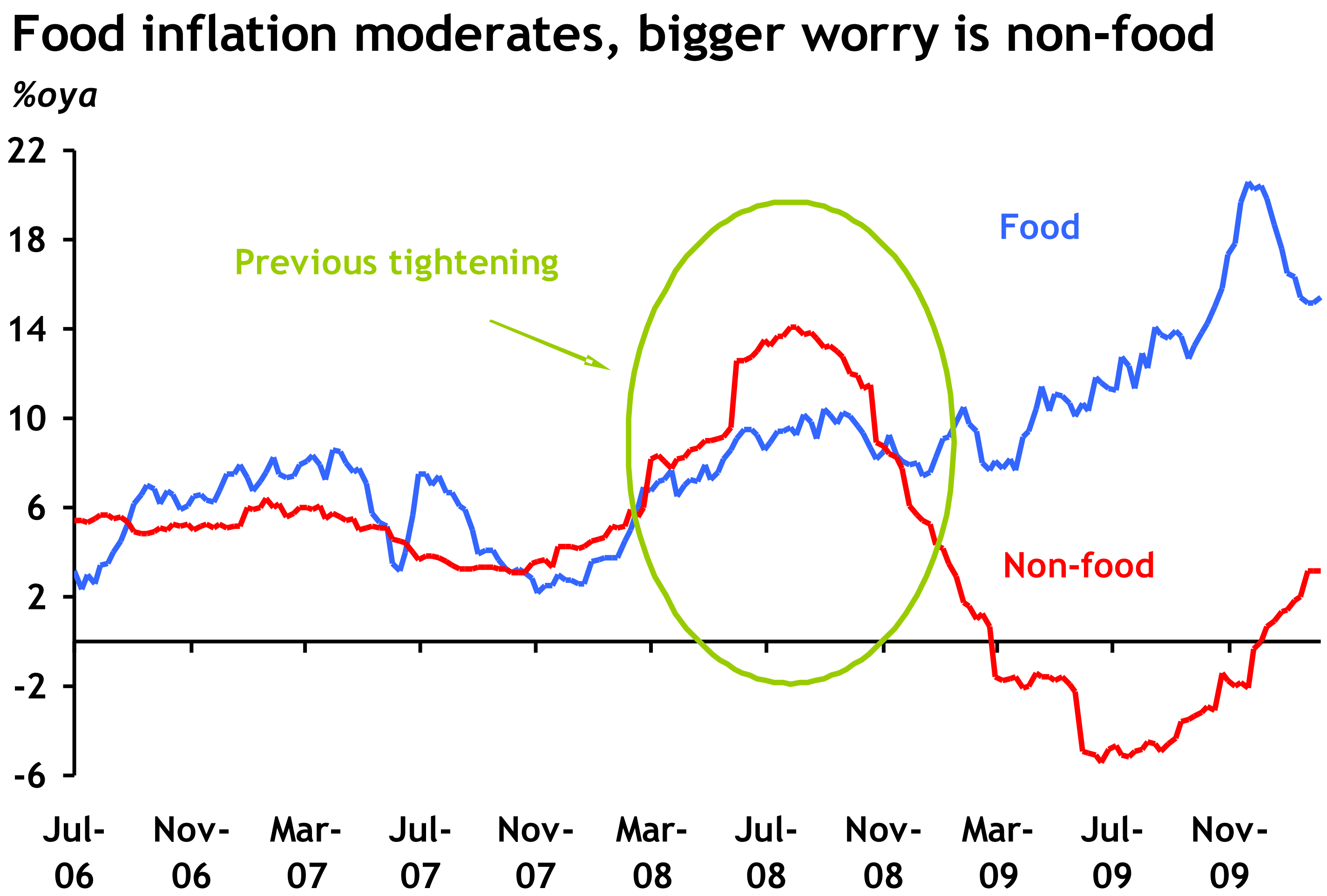
Output gap could close soon



Food inflation not credit dependent, but core is and it is rising



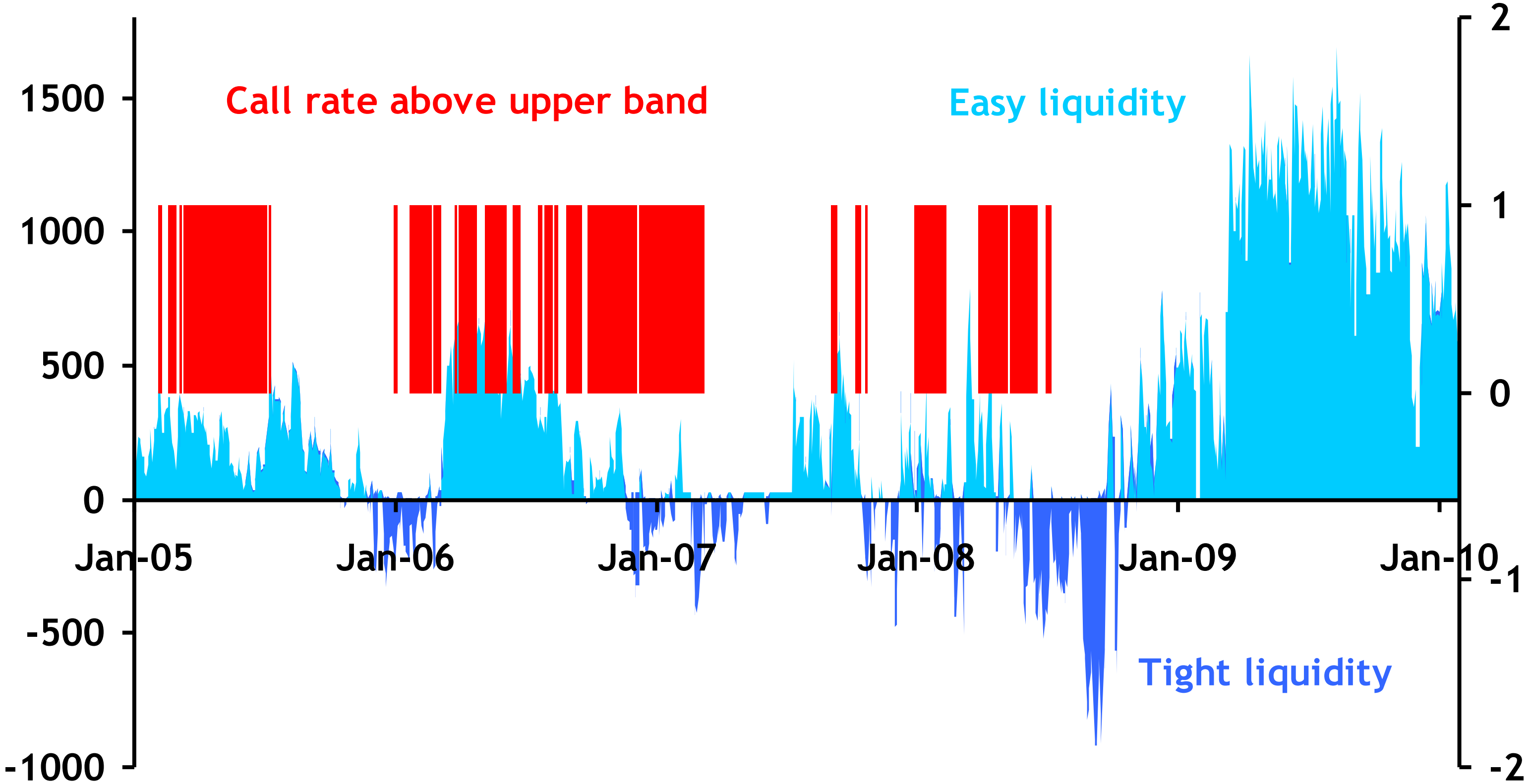
Policy stance

- Move to neutral from easy conditions quickly
- Hold at neutral until global uncertainty and domestic inflation path clarifies
  - Tighten if inflationary pressures persist
  - Loosen if global growth falters
- If position still easy in 2H10 and inflation picks up, tightening would have to be too aggressive (remember Jul-Aug 08) raising the spectre of a hard landing

Despite CRR hikes liquidity remains above normal

Call and Policy Rates

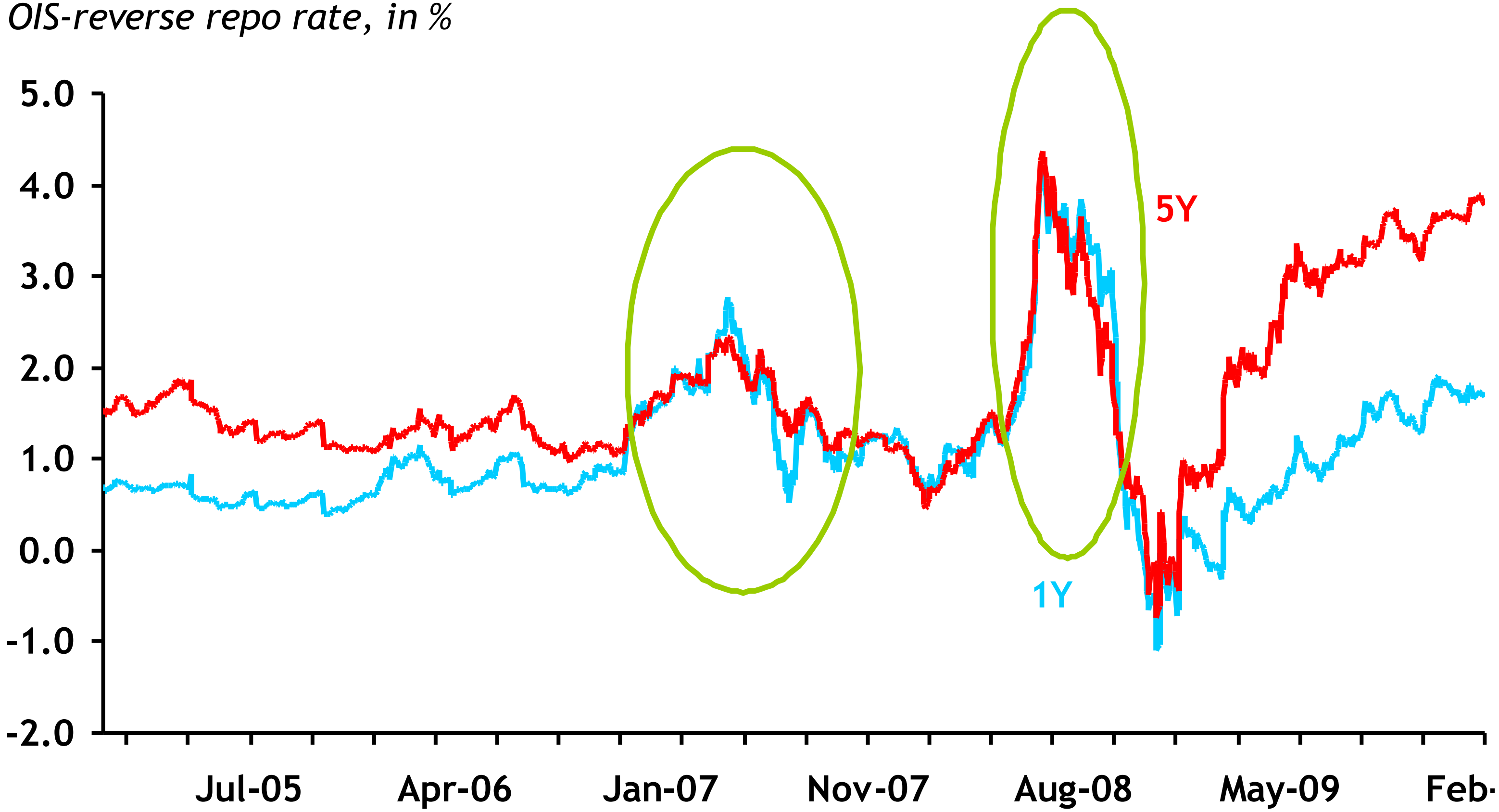
Rs bn both scales



Market underestimating the speed of policy hikes

Market pricing too little near term policy rate hike

OIS-reverse repo rate, in %



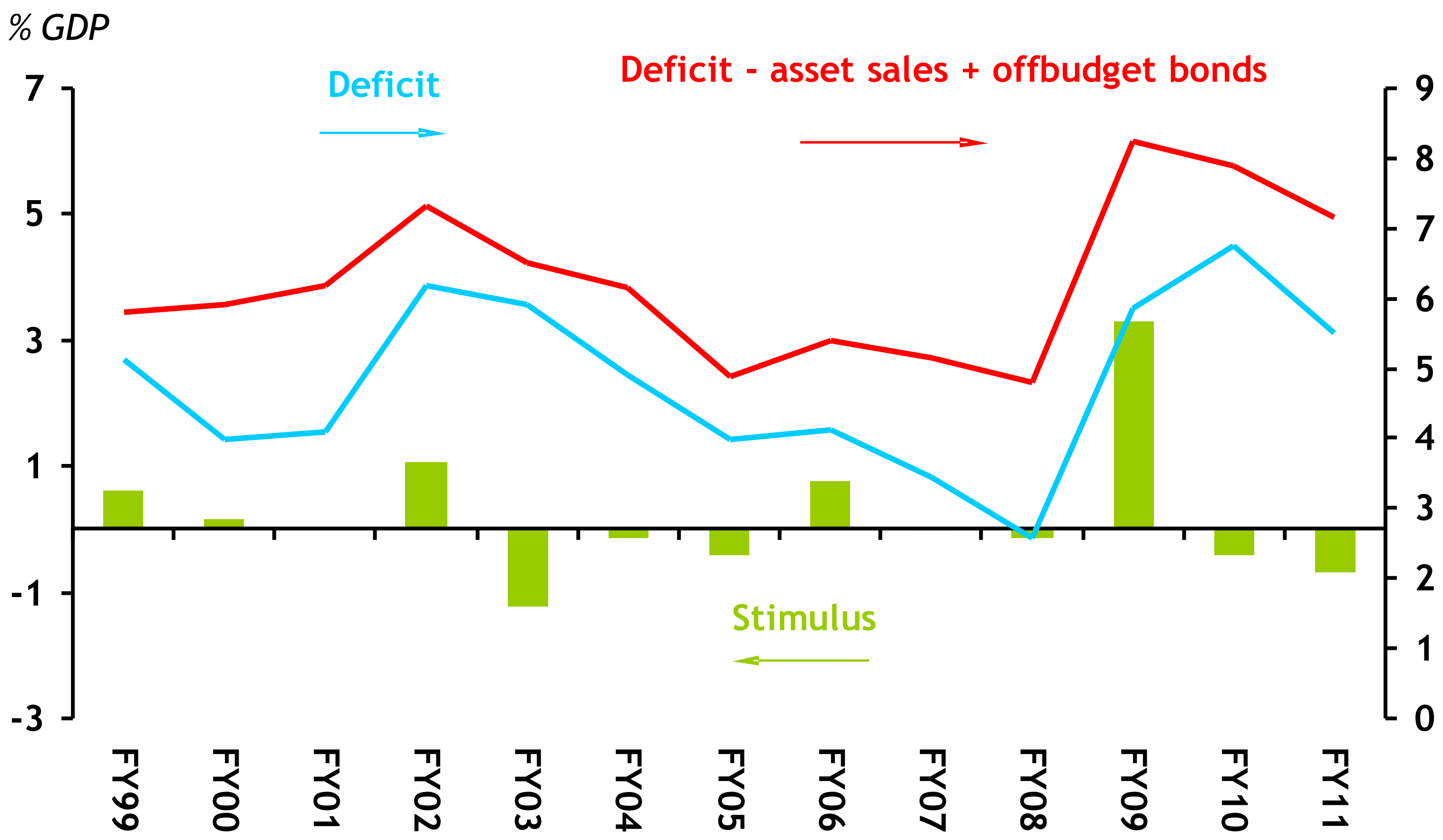
How much more tightening?

Unpleasant Monetary Arithmetic

	Call Rate	Expected Inflation	Real policy rate	Expected growth	Growth-interest gap	Monetary condition
Sep-07	6.5	5.0	1.5	9.0	7.5	Neutral
Sep-08	5.8	7.0	-1.3	8.0	9.3	Loose
Mar-09	3.3	4.0	-0.8	6.0	6.8	Tight
Mar-10	3.3	6.0	-2.8	8.0	10.8	Loose
	6.5	6.0	0.5	8.0	7.5	Neutral

Budget still pro growth

Less stimulus withdrawal than meets the eye



Financing risky

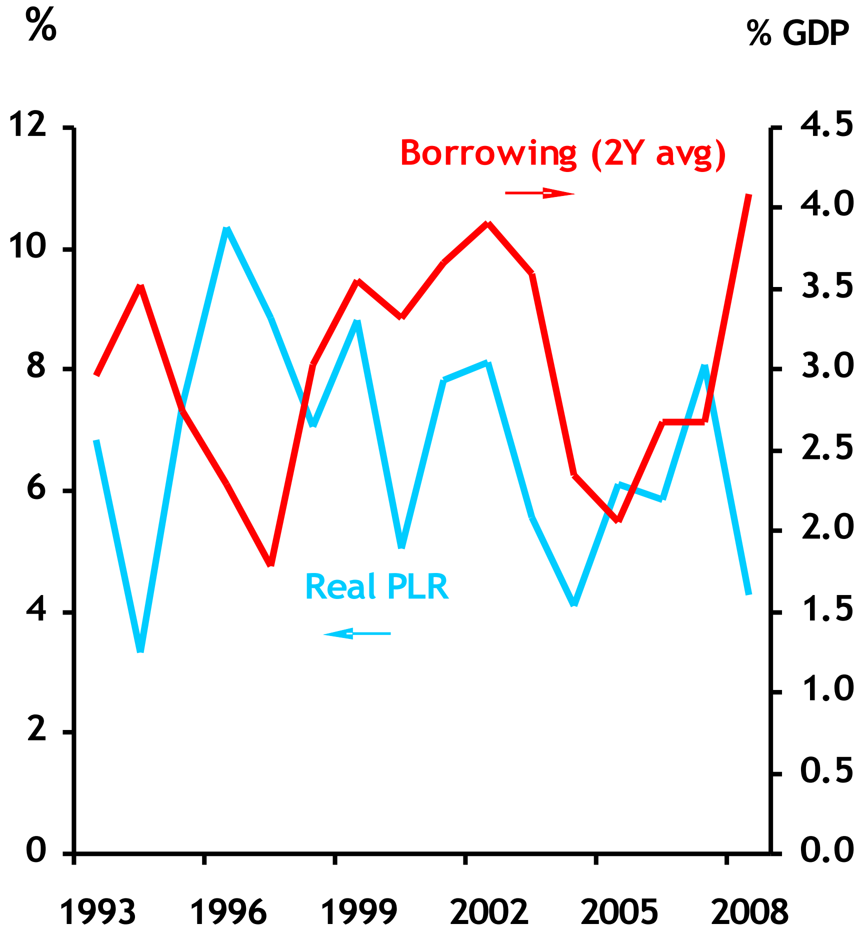
Recent deficit drivers

Rs bn, fiscal years beginning April 1

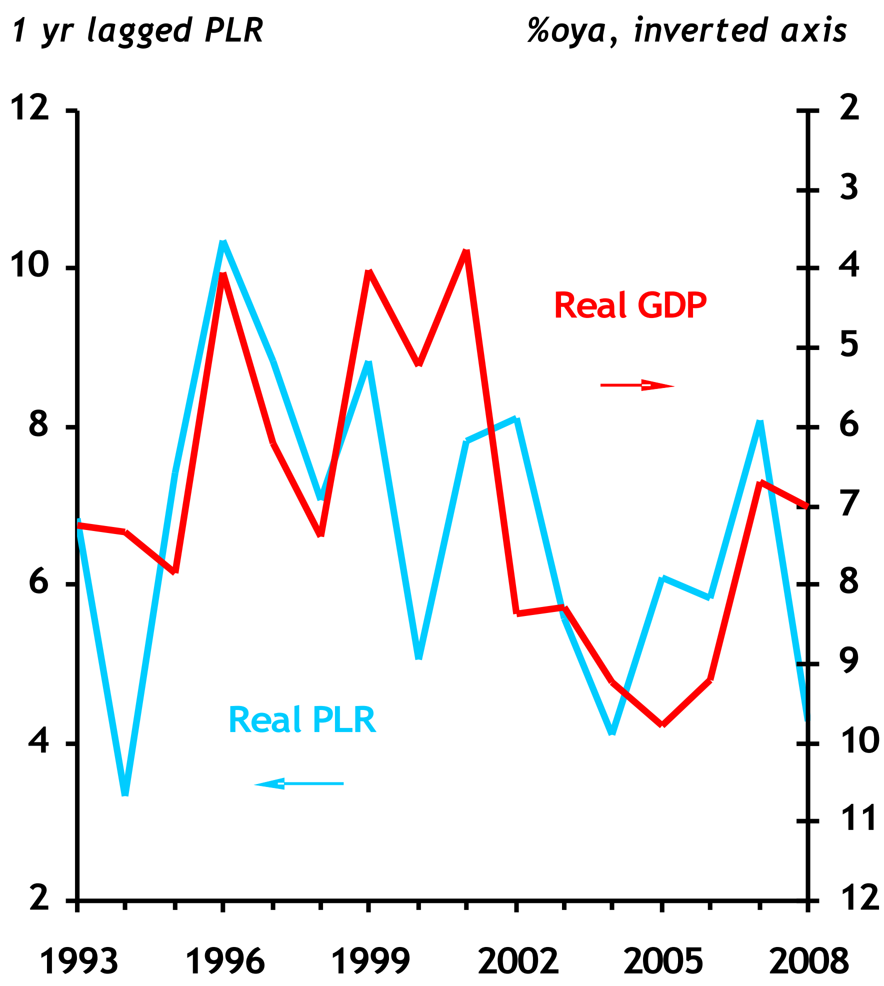
	FY09	FY10	FY11	FY11-FY10
Net borrowing	2336	3984	3450	-534
Disinvestment	6	260	400	140
Other capital reciepts	340	368	746	378
Oil subsidies	788	253	31	-222
Fertilizer subsidies	958	530	500	-30

Lower deficit in not anti-growth

Borrowing drives lending rates



Lending rate is a key driver of growth

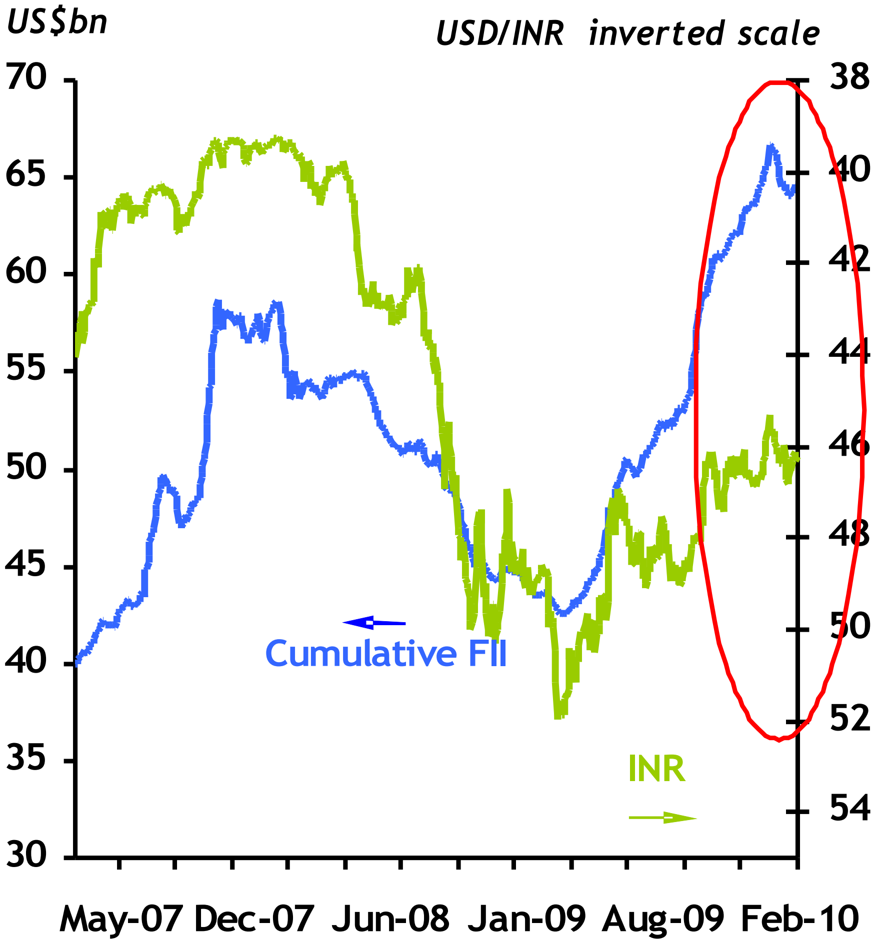


Budget financing need assurance

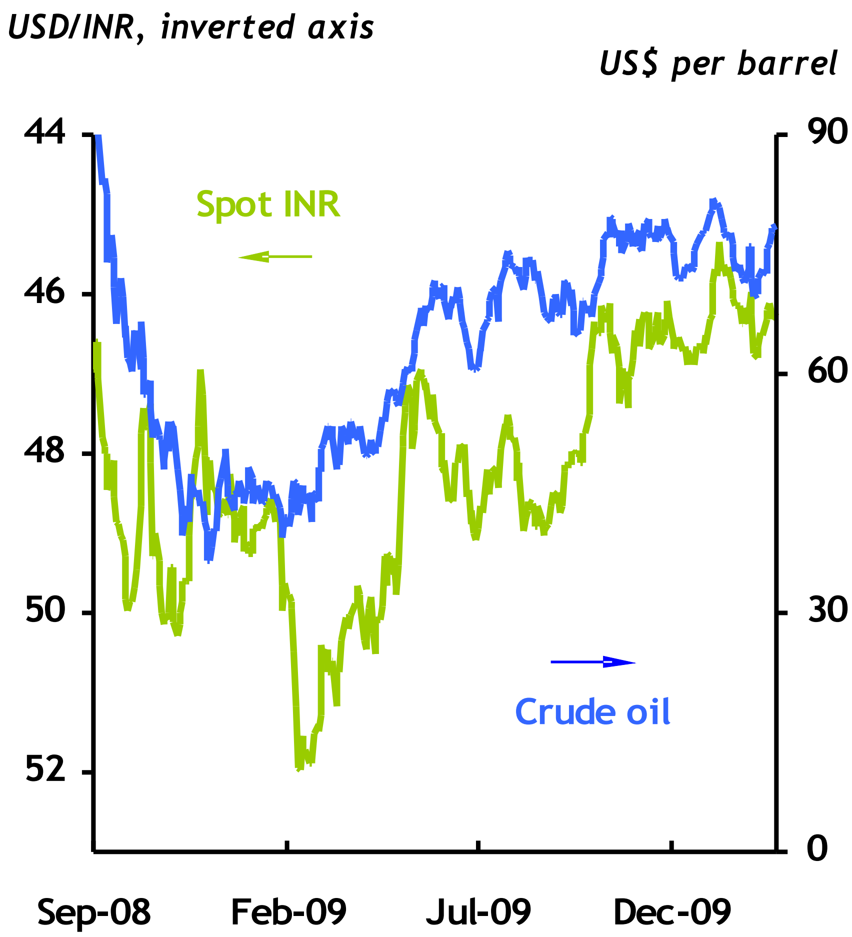
- Early 3G sales
- Early PSU disinvestment
- Early oil pricing reform

INR appreciation likely once global risk abates

FIIs will drive INR



… unless oil price spikes



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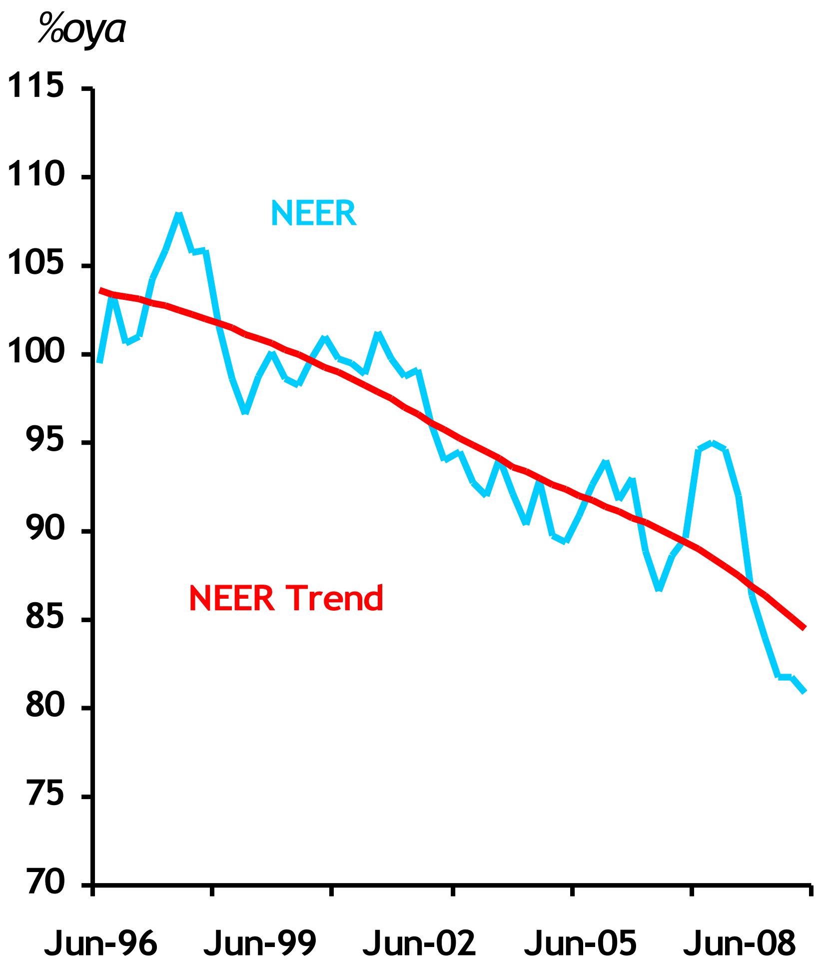
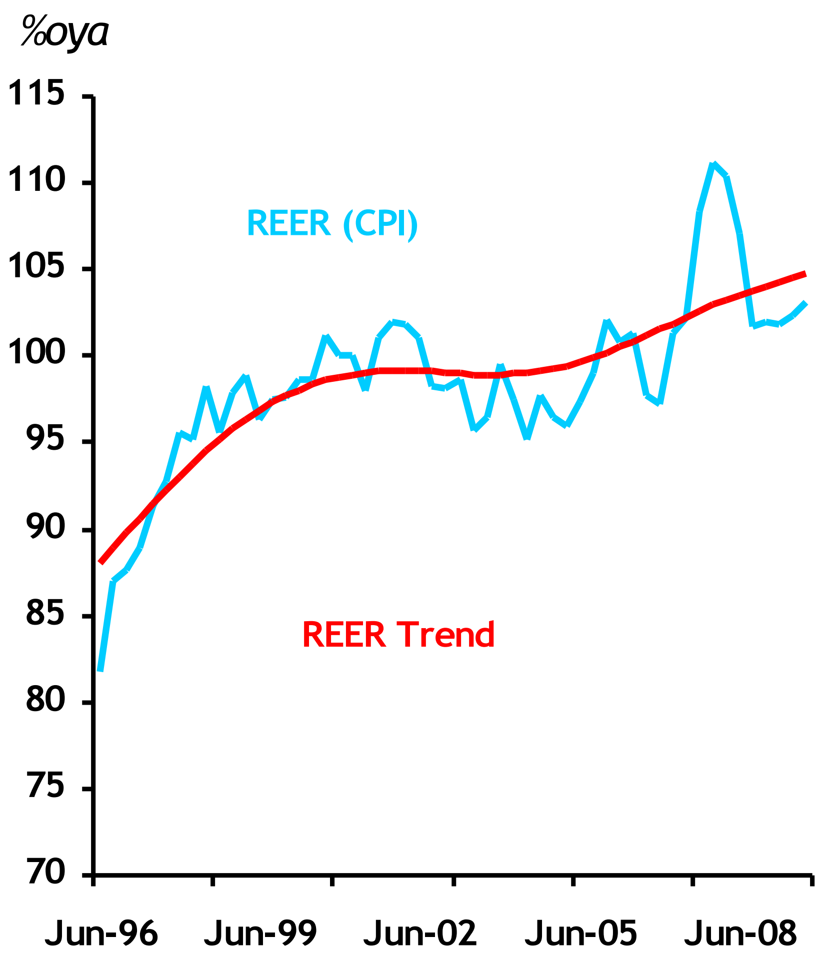
Exchange rate policy still biased towards nominal undervaluation

NEER has trended down 15%

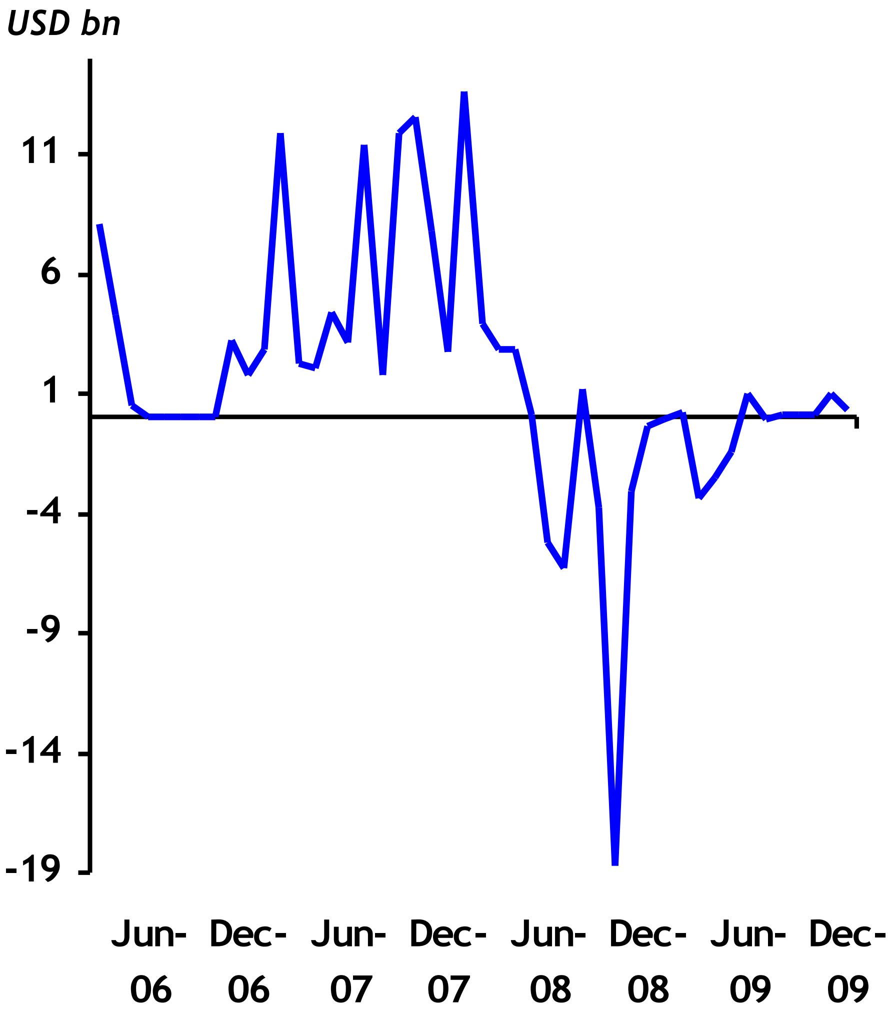


REER has trended up 15%



But FX management has improved lately

RBI intervention has reduced sharply



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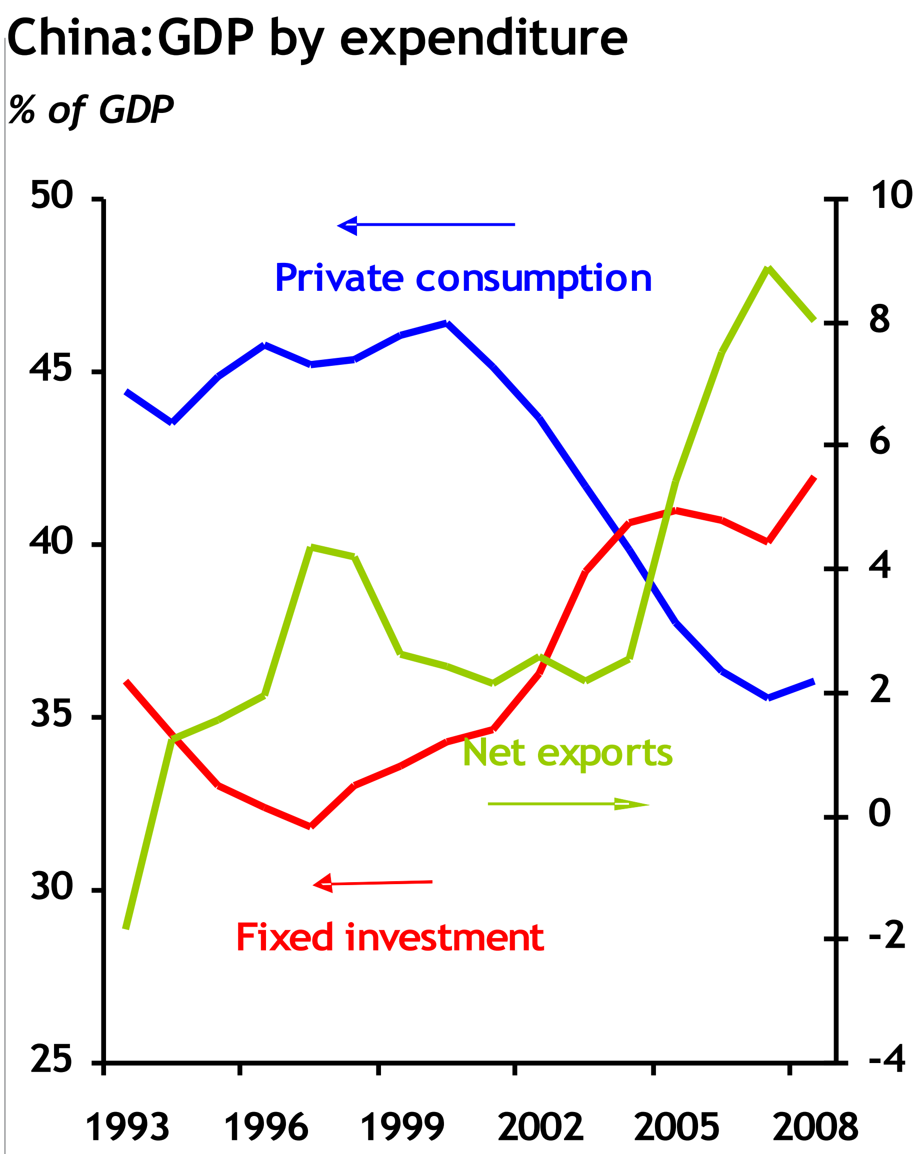
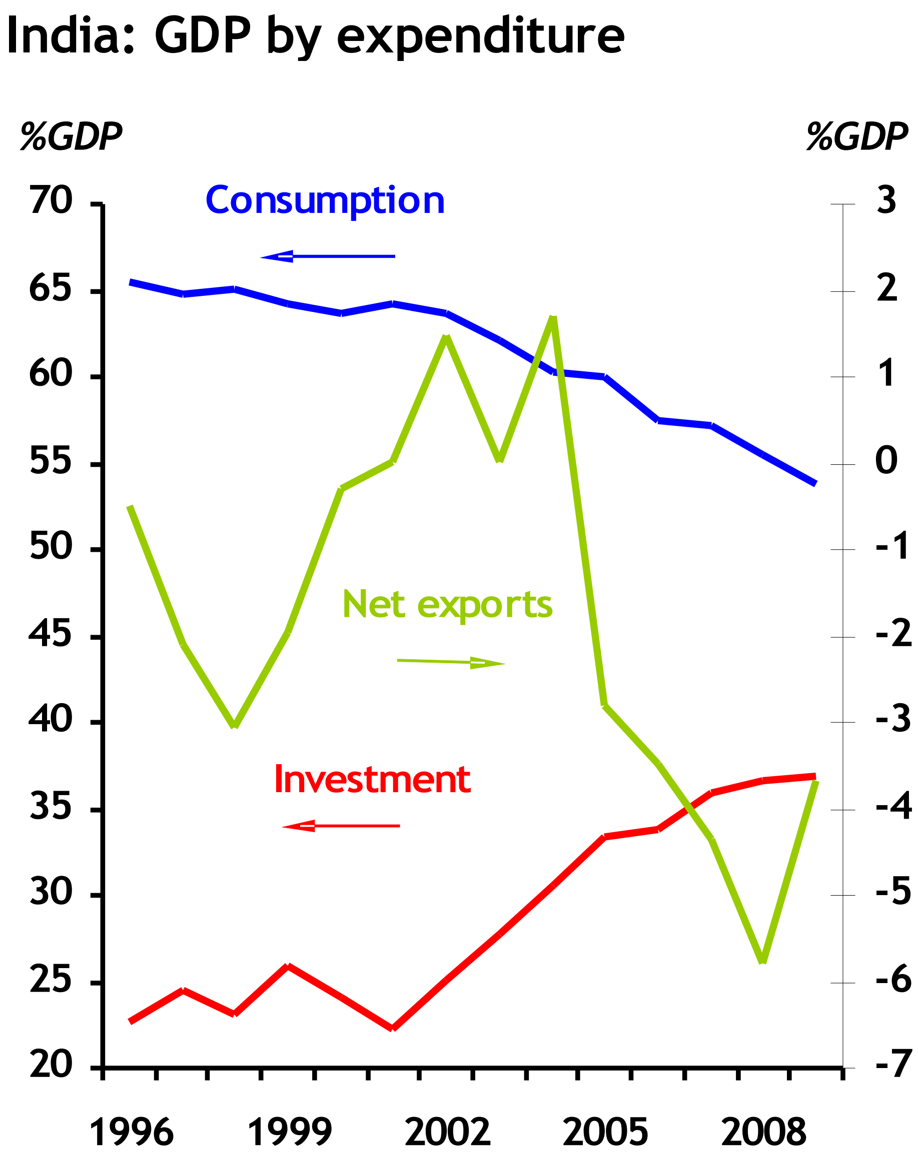
Going the China way?

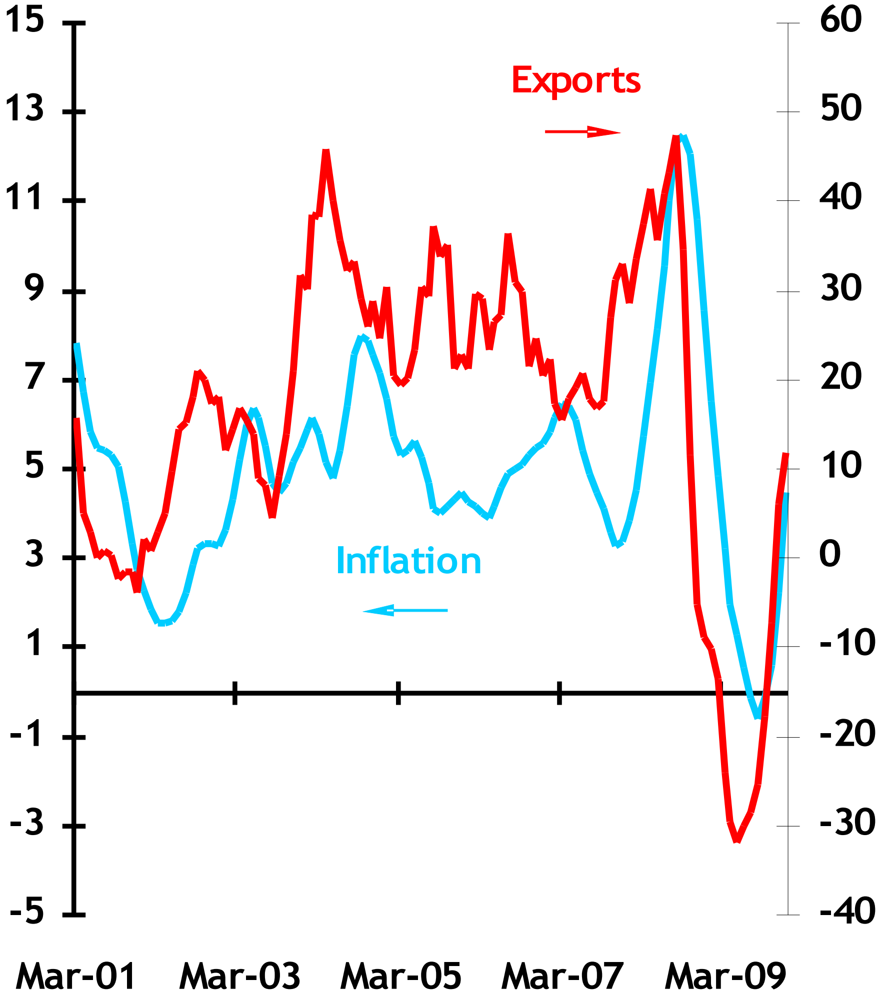




Going the China way?

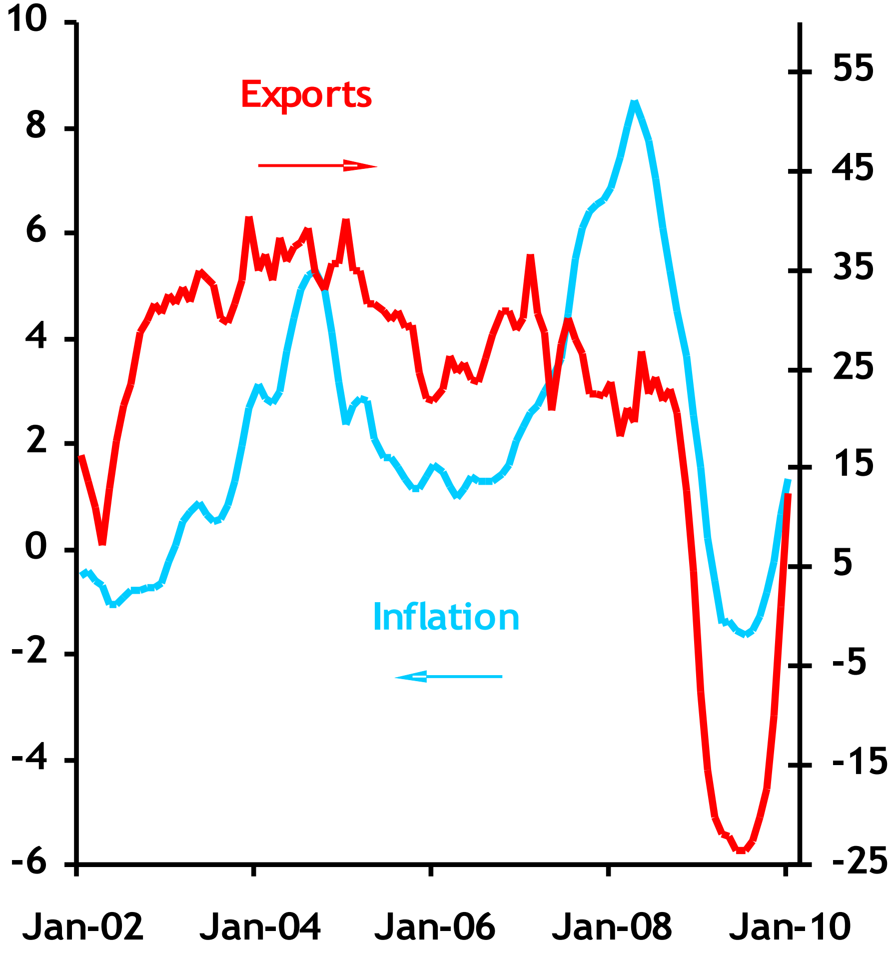
Inflation and exports

%oya, 3mma both scales



Inflation and exports

%oya, 3mma



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