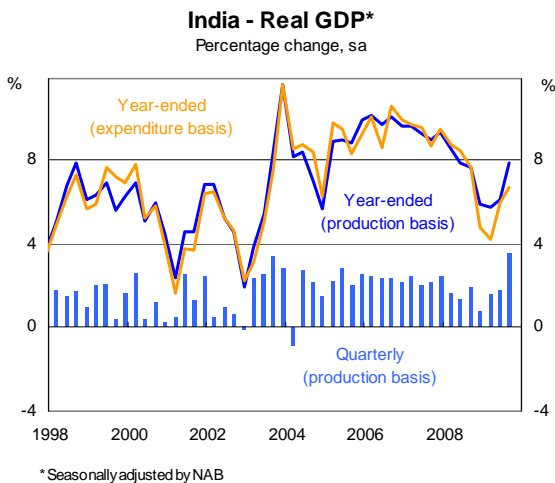


## Indian GDP – September Quarter 2009

The recovery in the Indian economy has continued to gather pace in the September quarter. GDP increased by 3.6 per cent in the quarter, to be 7.8 per cent higher over the year. The quarterly outcome easily exceeded market expectations and was the largest since the publication began in 1996. The result increases the likelihood of a more rapid tightening in policy next year. Overall, we anticipate the Indian economy to expand by 7 per cent in 2009.

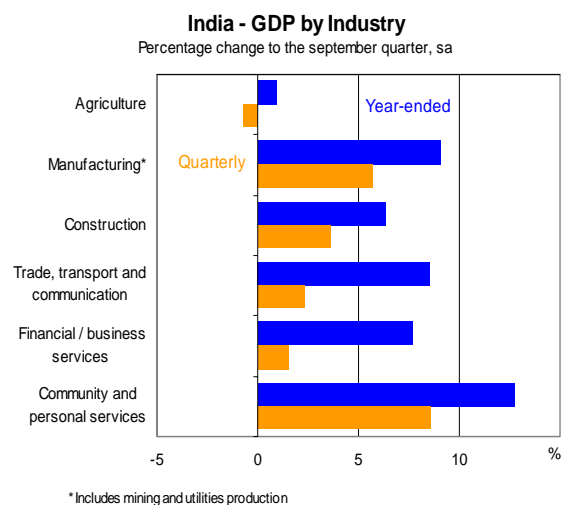


On an expenditure basis, the economy is estimated to have risen by 2½ per cent in the quarter and by 6¾ per cent over the year. The difference between the two measures of GDP is unclear, though the production measure is widely considered the more reliable and is reported more prominently by the Ministry of Statistics.

The expansion in production has been relatively broad across sectors. Manufacturing production

John O'Connor  
Economist - International  
+61 3 8634 8076  
John.F.O'connor@nab.com.au

increased by nearly 6 per cent in the quarter and monthly data indicates strong growth through the quarter. Vehicle production growth has been particularly strong, with the number of units produced up by nearly 50 per cent since December 2008. Agricultural production is the exception, declining slightly in the September quarter. Production has been hampered by a very poor monsoon season, in which rainfall was 20 per cent below long-run averages. While the agricultural sector only accounts for one-sixth of the economy, it employs three-fifths of the labour force and thus has significant welfare implications.

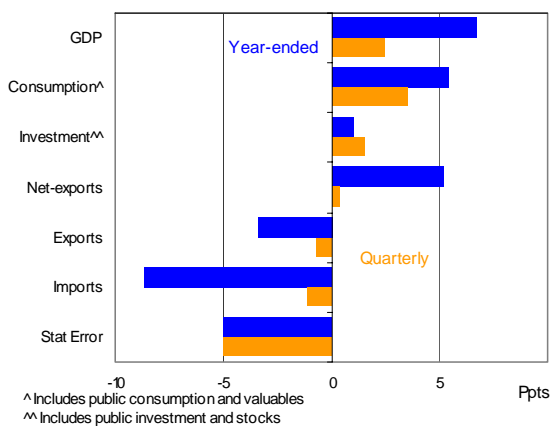


GDP by expenditure data illustrates three main factors that have contributed to India's robust growth: the resilience of consumption, the absence of a substantial contraction in investment, and relatively favourable export

performance.<sup>1</sup> The strength in consumption partly reflects higher public spending, though private consumption increased sharply in the September quarter. Households have substantial savings that they may have drawn on to supplement income. Investment, meanwhile, is likely to have been supported directly by fiscal stimulus programs and through lower funding costs.

### India - GDP by Expenditure Contributions

Contribution, September quarter sa

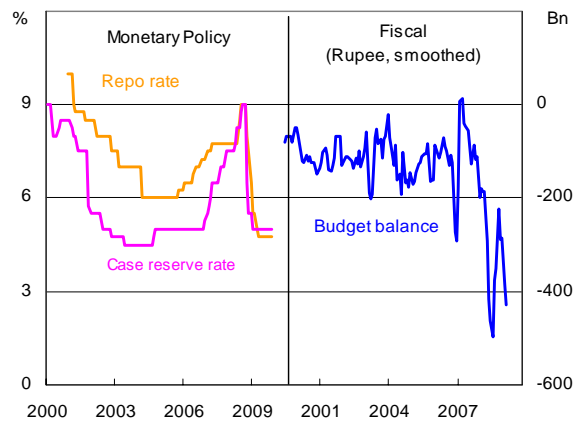


Net exports have contributed around 5 percentage points to GDP growth over the past year. Exports have fallen by only 15 per cent since their peak, while imports contracted by more than 30 per cent. The relatively better performance of exports may reflect the high share of services (~30 per cent on a value basis) which were not prone to the inventory-related slump that occurred in merchandise exports globally. Export volumes continued to fall in the September quarter, though the recovery in the global economy should support growth in coming quarters.

<sup>1</sup> Admittedly, the statistical error is relatively large and thus a cautious interpretation of components is required.

Underpinning the strength in domestic demand has been significant loosening in fiscal and monetary policy. In particular, the Reserve Bank of India (RBI) cut their policy rate by 425 basis points to 4¾ per cent and provided substantial liquidity to banks. The government also implemented fiscal stimulus packages worth around 2¾ per cent of GDP, comprising of both tax reductions and increased public expenditure. The effect of the stimulus packages are still supporting growth, as indicated by the recent widening in the budget deficit.

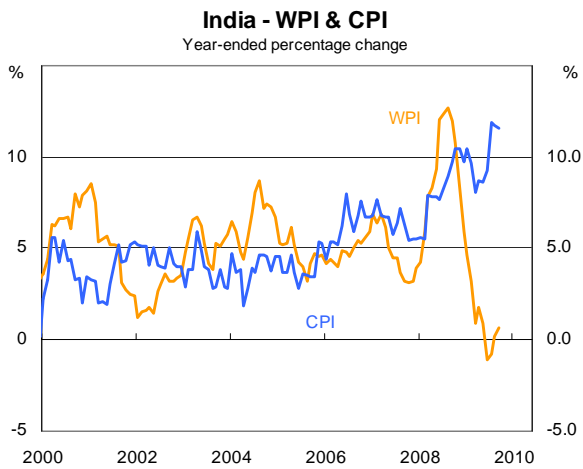
### India - Policy



Inflationary pressures have risen sharply. This is not readily evident given the divergence in measures; the WPI suggests mild *deflation* over the past year, while the CPI has risen by nearly 12 per cent. The divergence largely reflects different component weights – in particular for food – and base effects which is temporarily depressing WPI growth.<sup>2</sup> The latter is illustrated by annualised growth in the WPI of around 10 per cent in the past three months. Further, food

<sup>2</sup> The WPI gives food a weight of 16 per cent, compared with nearly 50 per cent in the CPI. This is particularly relevant at the moment since year-ended food inflation has recently been in excess of 10 per cent.

inflation is expected to persist due to the poor monsoon season.



Given these inflationary pressures and the strength of the domestic economy, stimulus measures will need to be wound back. Even prior to yesterday's better-than-expected GDP release, the government had announced that some of the stimulus measures would be withdrawn next year and the RBI had already moved to a tightening bias. Specifically, the RBI restored the statutory liquidity ratio to 25 per cent in October (from 24 per cent), and abolished two of the unconventional refinance facilities. At the time, the RBI forecast GDP growth of 6.5 per cent for fiscal 2009/10. This now seems too low, even if the economy stalled over the next six months. Thus, the argument for a faster policy tightening has increased.

# Macroeconomic, Industry & Markets Research

## Australia

Alan Oster	Group Chief Economist	+ (61 3) 8634 2927
Jacqui Brand	Personal Assistant	+ (61 3) 8634 2181

Vacant	Head of Australian Economics & Commodities	+ (61 3) 8634 2832
John Sharma	Economist - Australia	+ (61 3) 8634 4514
Ben Westmore	Economist - Australia & Commodities	+ (61 3) 8634 8602

Dean Pearson	Head of Industry Analysis	+ (61 3) 8634 2331
Gerard Burg	Economist - Industry Analysis	+ (61 3) 8634 2778
Daniel Farley	Economist - Property	+ (61 3) 8634 2168
Brien McDonald	Economist - Industry Analysis	+ (61 3) 8634 3837
Frank Drum	Economist - Agribusiness	+ (61 3) 8634 2041

Michael Lee	Senior Economist - Modelling & Econometrics	+ (61 3) 8634 8562
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Tom Taylor	Head of International Economics	+ (61 3) 8634 1883
Robert De Iure	Economist - Country Risk	+ (61 3) 8634 4611
John O'Connor	Economist - Asia	+ (61 3) 8634 8076
Mark Rodrigues	Economist - International	+ (61 3) 8634 1823

## Markets

Peter Jolly	Head of Markets Research	+ (61 2) 9237 1855
Robert Henderson	Chief Economist Markets - Australia	+ (61 2) 9237 1836
David de Garis	Senior Economist - Markets	+ (61 2) 9237 1180
Spiros Papadopoulos	Senior Economist - Markets	+ (61 3) 8641 0978

## New Zealand

Tony Alexander	Chief Economist - BNZ	+ (64 4) 474 6744
Stephen Toplis	Head of Markets Economics - BNZ	+ (64 4) 474 6905
Craig Ebert	Markets Economist - BNZ	+ (64 4) 474 6799
Mark Walton	Markets Economist - BNZ	+ (64 4) 474 6923

## London

Tom Vosa	Head of Markets Economics - UK	+ (44 20) 7710 1573
David Tinsley	Markets Economist - Europe	+ (44 20) 7710 2434

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