National Australia Bank

February 2007

India - rates lifted as growth accelerates

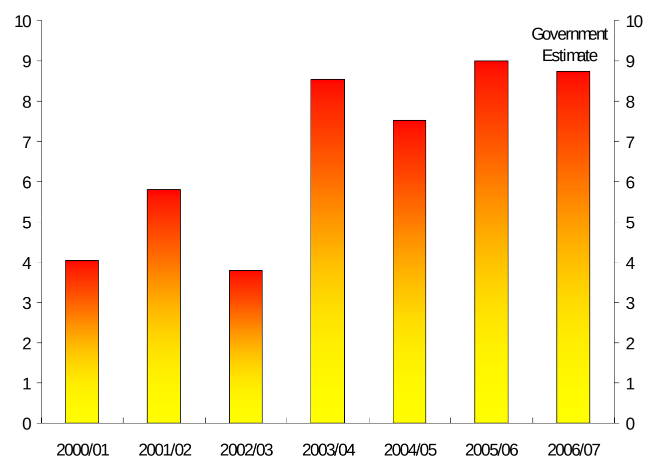
Key trends

- **Following its recent third quarter monetary policy review, the Reserve Bank of India (RBI) raised its overnight lending rate for the fifth time in a year in an attempt to curb inflationary pressure that is being fuelled by rapid economic growth.** In late-January, the RBI increased the repurchase rate by 25 basis points (bps) to a four-year high of 2.5%.

- **Upward pressure on interest rates is being fuelled by rapid economic growth. Real GDP in the second quarter of FY200/07 (July-September) increased by a faster-than-expected 9.2% yoy.** Consequently, real GDP growth in the first half of FY2006/07 stood at 9.1%, up from 8.5% in the first half of FY2005/06. The RBI is now expecting growth for FY2006/07 to be in the range of 8.5-9%, up from around 8% projected in its mid-year review. The partial data available for the third quarter indicates that the rapid growth momentum has slowed slightly, but the economy is still on track to meet the government's new growth forecast.

- **The focus of the RBI's third quarter monetary policy report was on the containment of inflation, which the RBI is aiming to keep in the range of 5-5.5% in FY2006/07.** Measured by the wholesale price index (WPI), inflation was running at 5.4% yoy in December, up from 4.1% yoy at the start of 2006. Based on the various consumer price measures, inflation has been rising more rapidly.

Annual Real GDP Growth (fiscal years)



M3 Money Supply Growth (% yoy)

Tom Taylor
Head of Economics - International
(613) 8641 3475
Tom_Taylor@national.com.au

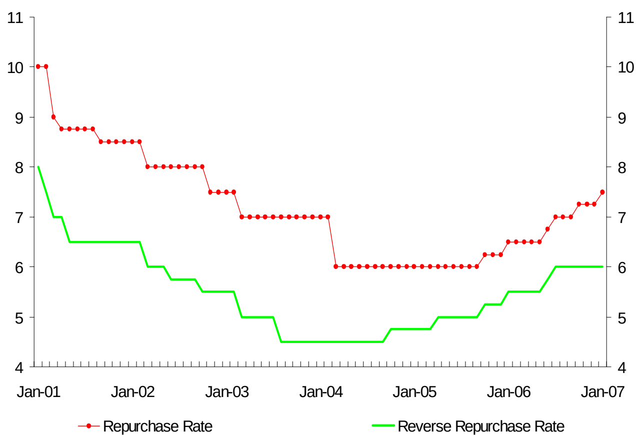
Robert De Iure
Economist – Country Risk
(613) 8641 3445
Robert_De_Iure@national.com.au

National Australia Bank

Rates lifted as growth accelerates

Following its recent third quarter monetary policy review, the Reserve Bank of India (RBI) raised its overnight lending rate for the fifth time in a year in an attempt to curb rising inflationary pressure that is being fuelled by very rapid economic growth. In late-January, the RBI increased the repurchase rate by 25 basis points (bps) to a four-year high of 2.5%, but it left its reverse repurchase rate unchanged at 6%.

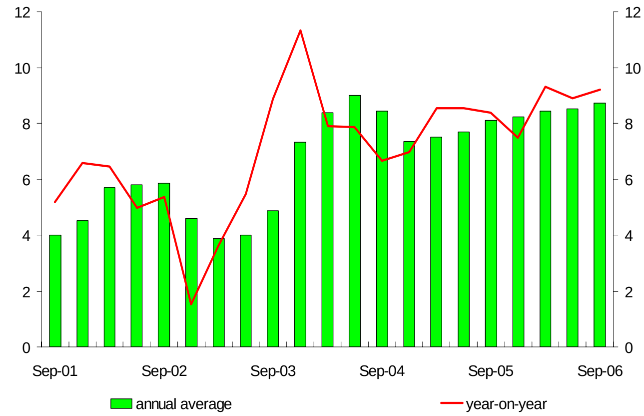
Chart 1: RBI Policy Rates



Upward pressure on interest rates is being fuelled by rapid economic growth. Real GDP in the second quarter of FY200/07 (July-September) increased by a faster-than-expected 9.2% yoy, underpinned by particularly rapid growth in both the manufacturing (11.8% yoy) and services (10.7% yoy) sectors. Consequently, real GDP growth in the first half of FY2006/07 stood at 9.1%, up from 8.5% in the first half of FY2005/06.

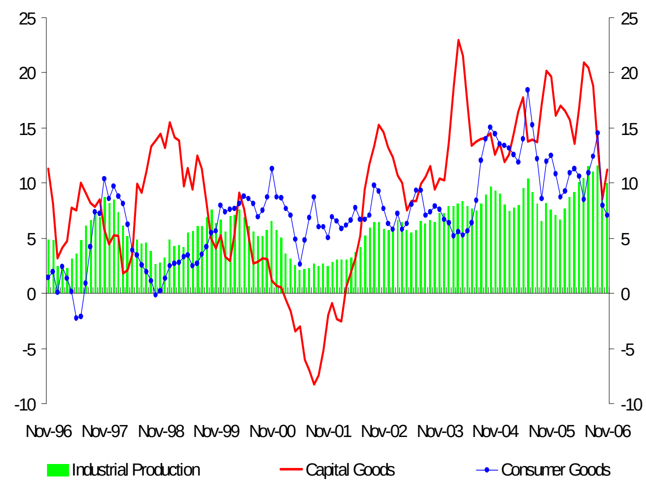
Real GDP growth in FY2005/06 was also revised up to 9% (from 8.4%), mainly reflecting a sharp upward revison in agricultural output growth. The revised estimates for 2005/06 indicated that domestic demand is playing a key role in driving the economy forward (quarterly expenditure data in India is not available). Real private consumption expenditure increased by 7% in FY2005/06, while investment spending grew by 16.5%.

Chart 2: Real GDP Growth (%)



The RBI is now expecting real GDP growth for FY2006/07 to be in the range of 8.5-9%, up from around 8% projected in its mid-year review. The partial data available for the third quarter indicates that the rapid growth momentum has slowed slightly, but that the economy is still on track to meet the government's new growth forecast.

Chart 3: Industrial Production (3mma, % yoy)



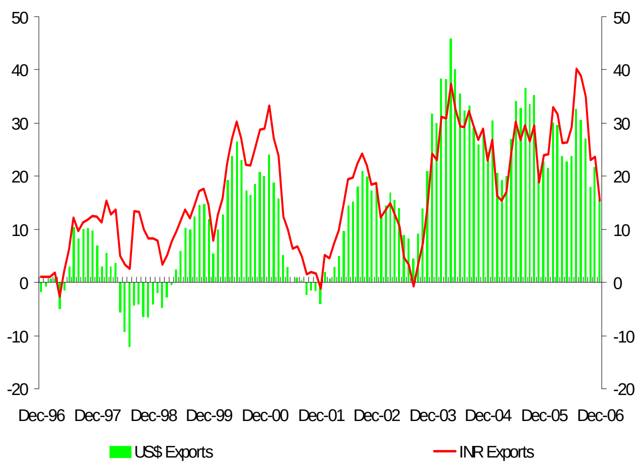
The industrial production index increased by 10% yoy in 3-month average terms in November, compared with an 11.6%

National Australia Bank

yoy increase in September. The business surveys are showing a moderation in optimism among Indian Industrialists, but expectations are still very high according to the latest RBI survey.

The industrial production data also confirms a slow down in investment spending - although it is still very strong with capital goods production growing by more than 11% yoy in November. The strength of investment spending is further underlined by 38.8% yoy increase in capital goods imports during April-September 2006.

Chart 4: Export Growth (3mma, % yoy)



Part of the slow down in industrial production growth reflects less rapid expansion in exports, with US$ export growth easing to 16.5% yoy in 3-month trend terms in December, down from the 20-30% rates of growth seen thorugh most of last year.

Rapid growth prompts overheating fears

The focus of the RBI's third quarter monetary policy report was on the containment of inflation, which the RBI is aiming to keep in the range of 5-5.5% in FY2006/07. Measured by the wholesale price index (WPI), inflation was running at 5.4% yoy in December, up from 4.1% yoy at the start of 2006. Based on the various consumer price measures, inflation has been rising more rapidly. CPI inflation for industrial workers was 6.7% yoy in December (4.4% yoy in January), while the CPI inflation rate for urban non-manual employees and agricultural labourers was 6.9% yoy (5% yoy in January) and 8.9% yoy (4.7% yoy in January) respectively. The divergence between consumer prices and wholesale prices is due to rising food prices, which have a much higher weighting in the CPI basket and there is a chance that food prices could ease in the coming months as the new harvest arrives.

Chart 5: Wholesale Price Inflation (% yoy)

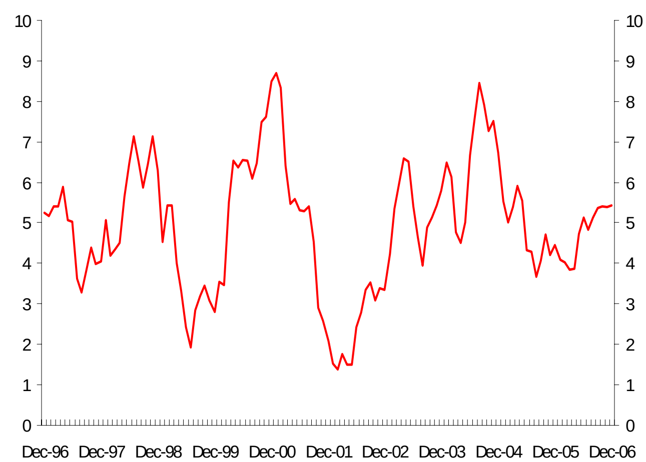
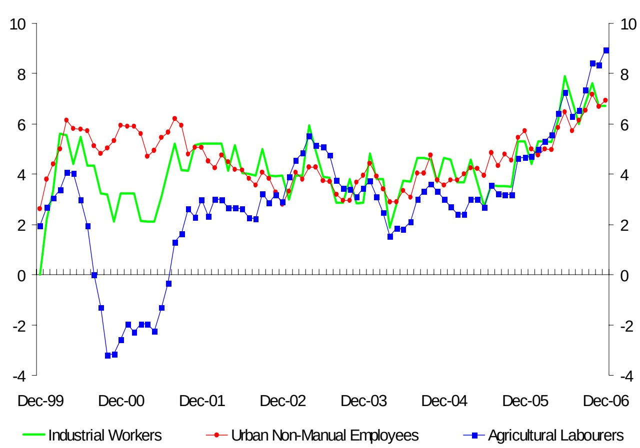
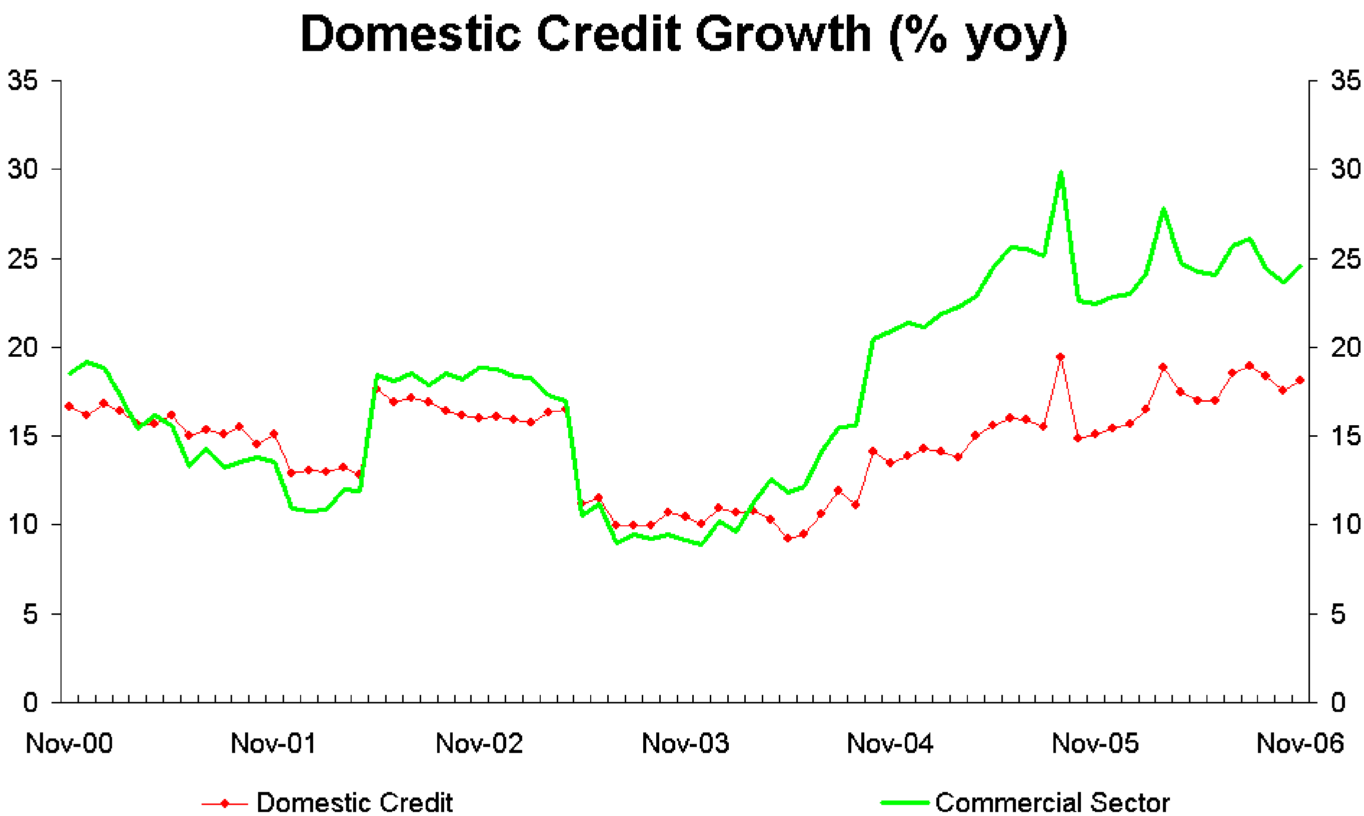


Chart 6: Consumer Price Inflation (% yoy)





While inflationary pressures partly reflect supply side pressures and capacity strains arising from rapid growth, demand pressures are also evident with high money and credit growth and rising asset prices playing a key role in boosting inflationary pressure.

Despite the RBI's monetary policy tightening bias, this does not appear to have dented demand for loans. Indeed, domestic credit growth was running at over 18% yoy in November, with domestic credit growth to the commercial sector exceeding 24% yoy. Meanwhile, M3 money supply growth was running at almost 20% yoy in December, while RBI loan data shows non-food bank credit growing by more than 31% yoy in early-January 2007.

The surge in bank credit has been underpinned by very strong real estate lending, with housing loans extended by scheduled commercial banks growing by more than 33% yoy in October and commercial real estate loans up by almost 84% yoy. The rapid pace of lending growth is now prompting concerns about deteriorating credit quality.

Overall, the strength of India's economic growth, combined with rising inflation and the continued very rapid rate of bank credit expansion suggest the need for further monetary tightening.

Macroeconomic, Industry & Markets Research

Australia

Alan Oster	Group Chief Economist	+(61 3) 8641 3464
Jacqui Brand	Personal Assistant	+(61 3) 8641 4179
Jeff Oughton	Head of Economics – Australia & Industry	+(61 3) 8641 3469
James McKinlay	Economist – Australia	+(61 3) 8641 4304
Dean Pearson	Senior Economist – Industry & Commodities	+(61 3) 8641 3474
Gerard Burg	Economist – Minerals & Energy	+(61 3) 8641 3984
John Sharma	Economist – Property, Business Services, TMTs	+(61 3) 8641 3473
Ian Gordon	Economist – Transport, Healthcare, Retailing	+(61 3) 8641 3472
Dean Wickenton	Economist – Manufacturing	+(61 3) 8641 3672
Skye Dixon	Economist – Agribusiness	+(61 3) 8641 3442
Tom Taylor	Head of Economist – International	+(61 3) 8641 3475
Robert De Iure	Economist – Country Risk	+(61 3) 8641 3445
Carolyn Fraser	Economist – International	+(61 3) 8641 3694
Vacant	Economist – International	+(61 3) 8641 3848
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 BNZ Market Economist	+(64 4) 474 6905
Craig Ebert	Senior Economist, Markets	+(64 4) 474 6799
Dean Ford	Market Economist	+(64 4) 474 6923

London

Tom Vosa	Head of Market Economics – UK	+(44 20) 7710 1573
Kris Bernie	Dollar Bloc	+(44 20) 7710 2910

DISCLAIMER: "[While care has been taken in preparing this material,] National Australia Bank Limited (ABN 12 004 044 937) does not warrant or represent that the information, recommendations, opinions or conclusions contained in this document ("Information") are accurate, reliable, complete or current. The Information has been prepared for dissemination to professional investors for information purposes only and any statements as to past performance do not represent future performance. The Information does not purport to contain all matters relevant to any particular investment or financial instrument and all statements as to future matters are not guaranteed to be accurate. In all cases, anyone proposing to rely on or use the Information should independently verify and check the accuracy, completeness, reliability and suitability of the Information and should obtain independent and specific advice from appropriate professionals or experts.

To the extent permissible by law, the National shall not be liable for any errors, omissions, defects or misrepresentations in the Information or for any loss or damage suffered by persons who use or rely on such Information (including by reasons of negligence, negligent misstatement or otherwise). If any law prohibits the exclusion of such liability, the National limits its liability to the re-supply of the Information, provided that such limitation is permitted by law and is fair and reasonable. The National, its affiliates and employees may hold a position or act as a price maker in the financial instruments of any issuer discussed within this document or act as an underwriter, placement agent, adviser or lender to such issuer."

UK Disclaimer: So far as the law and the FSA Rules allow, National Australia Bank Limited ("the Bank") disclaims any warranty or representation as to the accuracy or reliability of the information and statements in this document. The Bank will not be liable (whether in negligence or otherwise) for any loss or damage suffered from relying on this document. This document does not purport to contain all relevant information. Recipients should not rely on its contents but should make their own assessment and seek professional advice relevant to their circumstances. The Bank may have proprietary positions in the products described in this document. This document is for information purposes only, is not intended as an offer or solicitation nor is it the intention of the Bank to create legal relations on the basis of the information contained in it. No part of this document may be reproduced without the prior permission of the Bank. This document is intended for Investment Professionals (as such term is defined in The Financial Services and Markets Act 2000 (Financial Promotion) Order 2001) and should not be passed to any other person who would be defined as a private customer by the rules of the Financial Services Authority ("FSA") in the UK or to any person who may not have experience of such matters. Issued by National Australia Bank Limited A.C.N. 004 044 937, 88 Wood Street, London EC2V 7QQ. Registered in England BR1924. Head Office: 500 Bourke Street, Melbourne, Victoria. Incorporated with limited liability in the state of Victoria, Australia. Regulated by the FSA in the UK.

U.S DISCLAIMER: This information has been prepared by National Australia Bank or one of its affiliates or subsidiaries (collectively, "NAB"). If it is distributed in the United States, such distribution is by National Australia Capital Markets, LLC (NACM) which accepts responsibility for its contents. Any U.S. person receiving this information wishes further information or desires to effect transactions in the securities described herein should call or write to NACM, 200 Park Avenue, New York, NY 10166 (or call (877) 377-5480). The information contained herein has been obtained from, and any opinions herein are based upon sources believed to be reliable and no guarantees, representations or warranties are made as to its accuracy, completeness or suitability for any purpose. Any opinions or estimates expressed in this information is our current opinion as of the date of this report and is subject to change without notice. The principals of NACM or NAB and/or its affiliates may have a long or short position or may transact in the securities referred to herein or hold or transact derivative instruments, including options, warrants or rights with securities, or may act as a market maker in the securities discussed herein and may sell such securities to or buy from customers on a principal basis. This material is not intended as an offer or solicitation for the purchase or sale of the securities described herein or for any other action. It is intended for the information of clients only and is not for publication in the press or elsewhere.

National Australia Bank