RESERVE BANK OF INDIA

Macroeconomic and Monetary Developments First Quarter Review 2010-11

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Reserve Bank of India
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MACROECONOMIC AND MONETARY DEVELOPMENTS FIRST QUARTER REVIEW 2010-11

Overview

Global Economic Conditions

1. The global economy recovered faster than expected, led by robust growth in Emerging Market Economies (EMEs). Global output increased by over 5 per cent in Q1 of 2010 but it has hit a soft patch thereafter due to concerns stemming from the sovereign debt situation in the euro area. The IMF revised upwards its global growth projections for 2010 to 4.6 per cent from 4.2 per cent earlier. Recovery continues to remain uneven across countries in terms of both pace as well as sustainability. Fiscal austerity measures being adopted in many advanced economies could potentially dampen the growth impulses in these economies.

2. EMEs are expected to continue the process of normalisation of monetary policy in view of their stronger recovery, emerging inflationary pressures, and risks of asset price build-up. Advanced economies, on the other hand, may further delay monetary exit, due to the emergence of new risks to recovery, as also their well anchored inflation expectations. According to the IMF, while headline inflation in advanced economies could remain subdued at around 1.5 per cent or below, in emerging and developing economies inflation will edge up to more than 6 per cent in 2010.

3. The IMF assessment suggests that because of the low risk appetite of global investors in general after the euro area developments, capital flows to EMEs may decline initially before recovering again driven by their higher growth prospects and lower public debt. Exchange rates of key currencies have been highly volatile in recent months. While the Chinese yuan exhibited some appreciation, the euro has depreciated significantly. World trade, though recovering, is yet to revert to the pre-crisis level. Divergent growth and inflation conditions are likely to increase the asymmetry in the stance of monetary and fiscal policies across countries, which in turn could feed into the equity, foreign exchange and commodities markets to accentuate volatility.

Indian Economy – Trends and the Outlook

Output

4. Economic recovery gained further momentum, with robust growth in GDP recorded in the last quarter of 2009-10. Going by the progress of the monsoon so far, the agricultural output is expected to be better than last year. Industrial production continues to exhibit strong double digit growth in the current year, and notwithstanding some moderation in May 2010, the downside risks to growth are low. Lead indicators for services activities suggest continuation of the momentum. Thus, in 2010-11, GDP growth can be expected to be higher than 8.0 per cent projected in the April 2010 Monetary Policy Statement.

Aggregate Demand

5. Private investment demand recovered sharply, with gross fixed capital formation accelerating significantly in the last quarter of 2009-10. Production trends in capital goods point to continuation of the strong investment activities in the near-term. Disaggregated information such as production of consumer durables and non-durables, auto sales and non-oil imports suggest recovery in private consumption demand going forward. Government consumption demand would moderate reflecting the fiscal consolidation programmed in the budget. The recovery in export demand that began in November 2009 may slow in the months ahead because of developments in the euro area. Pick-up in demand for credit from the private sector, rapid growth in corporate sales, and information on order books available from forward looking surveys indicate strengthening of domestic demand. Overall, private consumption and investment demand would be the two major drivers of growth during 2010-11.

Fiscal Conditions

6. The fiscal consolidation plans programmed in the Union Budget for 2010-11 will benefit from the larger than expected mobilisation from 3G/ Broadband Wireless Access (BWA) spectrum auctions, which alone could reduce the fiscal deficit by 1 percentage point of GDP. The partial deregulation/upward revision to the prices of petroleum products in June 2010 will contain pressure on the fiscal situation from under-recoveries of the public sector oil companies. While the price adjustment in the petroleum sector may add to headline inflation in the near-term, improved fiscal situation would be congenial to both inflation and growth outlook in the medium run.

External Sector

7. With recovery in growth of exports and the return of capital flows, the external sector conditions improved during 2009-10. The current account deficit, however, widened to 2.9 per cent of GDP in 2009-10, from 2.4 per cent in 2008-09, which contributed to the recovery through higher absorption of foreign capital. In 2010-11 so far, import growth remains strong while capital inflows have moderated led by the decline in portfolio flows. During 2009-10, foreign exchange reserves increased by US$ 13.4 billion (excluding valuation gains) and by US$ 27.1 billion (including valuation gains). As on July 16, 2010, the reserves stood at US$ 281.9 billion.

Monetary and Liquidity Conditions

8. The surplus liquidity conditions that prevailed all through 2009-10 started moderating in early 2010-11 in response to the calibrated normalisation of monetary policy by the Reserve Bank. In June 2010, however, there was a severe tightness in liquidity conditions resulting from a sudden and sharp increase in the government cash balances arising out of significantly higher mobilisation under 3G/BWA spectrum auctions. While mitigating the liquidity pressure, the Reserve Bank persevered with calibrated monetary tightening keeping in view the higher level of inflation. Between April and July 2010, the repo and reverse repo rates were raised cumulatively by 50 basis points and the CRR was raised by 25 *basis points. Reflecting increased demand for credit associated with recovery in growth, non-food credit growth to the private sector remained buoyant.*

Financial Markets

9. In the first quarter of 2010-11, the volatility in global markets emanating from concerns about fiscal sustainability in the euro area, spilled over to the Indian markets, particularly the equity market. Reflecting the tight liquidity conditions in June 2010, interest rates at the short end of the term structure edged up, while medium to long-term yields moderated, in view of the improved fiscal position after 3G/BWA auction revenues. In the credit market, credit spreads moderated while credit growth accelerated, suggesting improved credit conditions. The banking sector switched over to a new "base rate" system of lending effective July 1, 2010, which is expected to enhance transparency in loan pricing, promote competition in the credit market and also improve the transmission of monetary policy. The base rates set by major public sector banks were in the narrow range of 7.25-8.0 per cent. In the housing market, the pace of increase in house prices over successive quarters moderated somewhat in the fourth quarter of 2009-10.

Inflation

10. Headline WPI inflation has been in double digits since February 2010 and also become increasingly generalised in every successive month. Non-food manufacturing inflation accelerated from near zero in November 2009 to 7.3 per cent in June 2010, reflecting the impact of rising input costs, recovering private demand and associated return of pricing power. In the last few months, price increases also reflected upward revisions in several administered prices or delayed reporting of data. Monetary policy may not be the most effective instrument to deal with supply side pressures on inflation. But repeated supply shocks and administrative price increases not only increase inflation persistence but also aggravate inflation expectations. For containing the inflation persistence and anchoring inflation expectations, anti-inflationary monetary policy actions become a necessity, notwithstanding the importance of supply augmenting structural measures to ensure a sustained low inflation regime.

Overall Assessment

11. The normalisation of monetary policy has been conditioned by the growth-inflation dynamics characterised by robust acceleration in growth and increasing generalisation of the double digit inflation. While external conditions have turned more uncertain after the sovereign debt related stress in the euro area, the outlook in India points to further consolidation in growth during the course of the year, driven largely by pick-up in private consumption and investment demand. For the conduct of monetary policy, emerging demand side pressures on inflation, increasing generalisation of the inflation path and persistence of high food price inflation need to be assessed along with the expected favourable impact of a better monsoon than last year on food prices. With receding concerns relating to the recovery and given the emerging risks of generalised inflation, monetary policy measures have to continue the calibrated normalisation process.

I. OUTPUT

The Indian economy exhibited robust acceleration in the pace of recovery in the fourth quarter of 2009-10, led by strong double digit growth in industrial activities. Contrary to earlier concerns about the adverse impact of the deficient monsoon, the agricultural output showed modest positive growth. Services activities, which had remained resilient throughout the phase of slowdown, showed further pick-up in momentum. Excluding the "community, social and personal services" segment, growth in services sector in the fourth quarter of 2009-10 reached closer to the pre-global crisis trend. The IIP has continued to grow at a robust pace in 2010-11 so far, notwithstanding some moderation in May 2010. Lead indicators for services sector also suggest continuation of the robust trend. Capacity utilisation rate remained high and employment growth was positive unlike the jobless recovery seen in advanced economies. Overall GDP growth in 2010-11 could be expected to accelerate further to get closer to its trend rate.

I.1 The real GDP growth for 2009-10 was revised upwards to 7.4 per cent from the earlier estimate of 7.2 per cent, mainly on account of strong growth of 8.6 per cent in the fourth quarter as well as upward revision in growth figures for earlier quarters (Table I.1). In Q4 of 2008-09, the pace of deceleration in growth was the maximum. The acceleration in Q4 of 2009-10 resulted despite weak agriculture sector performance

Table I.1: Growth Rates of Real GDP@

(Per cent)

Sector	2008-09*	2009-10#	2008-09				2009-10			
			Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
1	2	3	4	5	6	7	8	9	10	11
1. Agriculture and Allied Activities	**1.6**	**0.2**	**3.2**	**2.4**	**-1.4**	**3.3**	**1.9**	**0.9**	**-1.8**	**0.7**
	(15.7)	**(14.6)**								
2. Industry	**3.1**	**10.4**	**5.2**	**4.9**	**1.7**	**0.8**	**4.6**	**9.0**	**12.3**	**15.1**
	(20.0)	**(20.5)**								
2.1 Mining and Quarrying	1.6	10.6	2.6	1.6	2.7	-0.3	8.2	10.1	9.6	14.0
2.2 Manufacturing	3.2	10.8	5.9	5.5	1.3	0.6	3.8	9.1	13.8	16.3
2.3 Electricity, Gas and Water Supply	3.9	6.5	3.3	4.3	4.0	4.1	6.6	7.7	4.7	7.1
3. Services	**9.3**	**8.3**	**9.8**	**9.3**	**10.0**	**8.0**	**7.5**	**10.0**	**7.3**	**8.5**
	(64.4)	**(64.9)**								
3.1 Trade, Hotels, Restaurants, Transport, Storage and Communication	7.6	9.3	10.8	10.0	4.4	5.7	5.5	8.5	10.2	12.4
3.2 Financing, Insurance, Real Estate and Business Services	10.1	9.7	9.1	8.5	10.2	12.3	11.8	11.5	7.9	7.9
3.3 Community, Social and Personal Services	13.9	5.6	8.7	10.4	28.7	8.8	7.6	14.0	0.8	1.6
3.4 Construction	5.9	6.5	9.8	7.2	1.1	5.7	4.6	4.7	8.1	8.7
Real GDP at Factor Cost	**6.7**	**7.4**	**7.8**	**7.5**	**6.1**	**5.8**	**6.0**	**8.6**	**6.5**	**8.6**
	(100)	**(100)**								
Memo:										(Amount in Rupees crore)
Real GDP at Factor Cost(2004-05)	41,54,973	44,64,081								
GDP at current market prices	55,74,449	62,31,171								

@ : At 2004-05 Prices. * : Quick Estimates. # : Revised Estimates.

Note: Figures in parentheses indicate shares in real GDP.

Source: Central Statistical Organisation.

as well as tapering off of the stimulus measures' impact on the "*community, social and personal services*" sector.

Agricultural Situation

I.2 Rainfall during the South-West monsoon season of 2010 (June to September) is likely to be 102 per cent of the long period average (LPA) (with a model error of ± 4.0 per cent) as per the revised forecasts dated June 25, 2010 by the India Meteorological Department. The cumulative area weighted rainfall during the season so far (up to July 21, 2010) has been 14 per cent below LPA as against 19 per cent below LPA during the corresponding period of the previous year. Of the 36 meteorological subdivisions, cumulative rainfall was excess/normal in 26 sub-divisions (21 sub-divisions last year) (Chart I.1). As on July 22, 2010, the total live water storage in 81 major reservoirs of the country was 19 per cent of the Full Reservoir Level (24 per cent during the corresponding period last year).

I.3 Available data show that the area sown during *kharif* 2010 (as on July 22) was higher than in the corresponding period of the previous year for all crop categories. The area coverage was, however, lower in a few individual crops such as urad, jowar, maize and soyabean, mainly due to deficient monsoon in the respective crop growing states of Rajasthan and Madhya Pradesh (Table I.2).

Table I.2: Area Sown under *Kharif* Crops

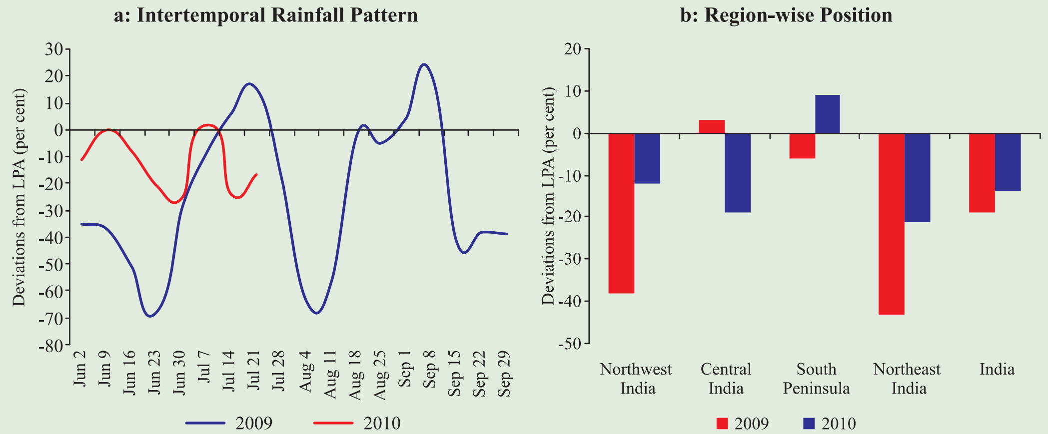
(in lakh hectares)

Crop	Normal Area during *Kharif* Season	Area Sown Reported		% Variation over Previous year	% of Normal *Kharif* Area
		2010-11*	2009-10*		
1	2	3	4	5	6
Rice	395.10	169.71	157.67	7.6	43.0
Coarse Cereals	222.23	141.42	132.40	6.8	63.6
Total Pulses	107.94	57.23	50.55	13.2	53.0
of which					
Tur	35.53	26.56	21.76	22.1	74.8
Urad	22.82	12.83	12.92	-0.7	56.2
Moong	26.14	13.60	11.01	23.5	52.0
Total Foodgrains	725.27	368.36	340.62	8.1	50.8
Total Oilseeds	175.72	129.49	123.89	4.5	73.7
of which					
Groundnut	53.81	38.10	30.88	23.4	70.8
Soyabean	84.00	80.28	81.53	-1.5	95.6
Sesamum	17.76	6.52	5.98	9.0	36.7
Cotton	90.86	95.04	80.63	17.9	104.6
Sugarcane	44.97	47.37	41.79	13.4	105.3
Jute	7.85	7.60	6.89	10.3	96.8
All Crops	1044.67	647.86	593.82	9.1	62.0

* : As on July 22.

Source: Ministry of Agriculture, Government of India.

Chart I.1: South-West Monsoon Pattern (area weighted rainfall)



I.4 The Fourth Advance Estimates for agricultural production in 2009-10 placed the foodgrains output at 218.2 million tonnes, a decline of 6.9 per cent over the preceding year.

Food Management

I.5 The total stock of foodgrains with the Food Corporation of India (FCI) and other government agencies, increased to 58.4 million tonnes as on July 1, 2010 (Chart I.2). Since food price inflation has remained high despite rising stock of foodgrains much above the buffer norms, the policy on food management has to focus on better supply management in relation to demand besides addressing the structural capacity constraints in food items.

Industrial Performance

I.6 The industrial sector has maintained double digit growth since August 2009 (except September 2009) (Chart I.3). Increasingly manufacturing growth is being led by capital goods industries and consumer durables (Chart I.4a, b and Table I.3). The pick-up in capital goods production was mainly on account of acceleration in segments like "machinery and equipment other than transport equipment", "metal products and parts" and "transport equipment". Although industrial output decelerated marginally in the month of May 2010 as compared to 15 per cent growth recorded during Q4:2009-10, the pace of the increase is still robust. Notwithstanding the impact of the base effect and possible

Chart I.3: Growth in Index of Industrial Production (y-o-y)

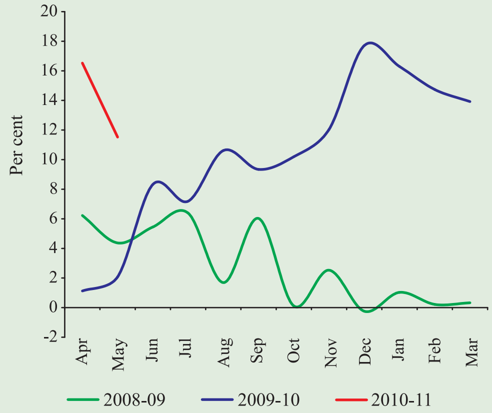
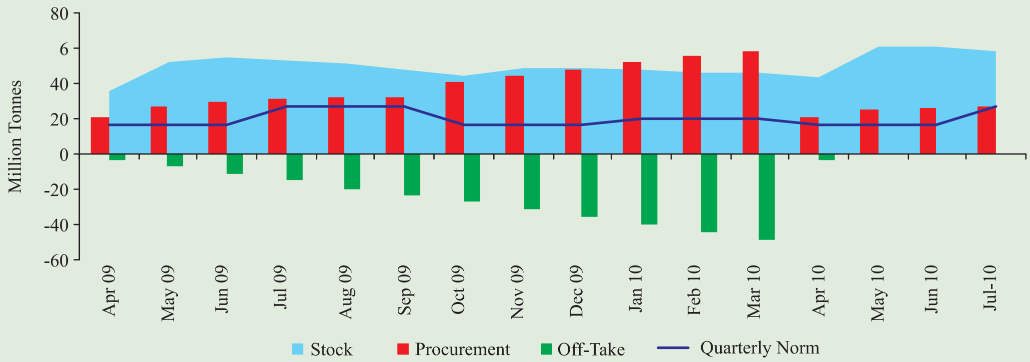
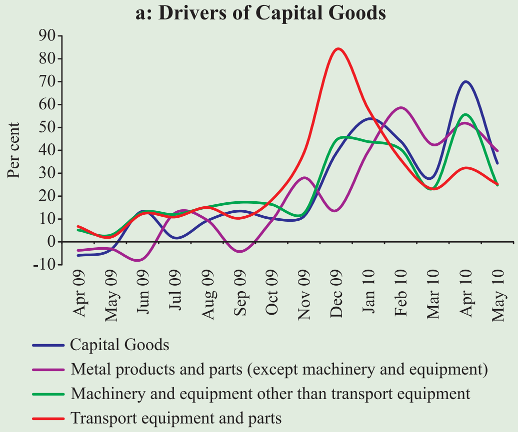


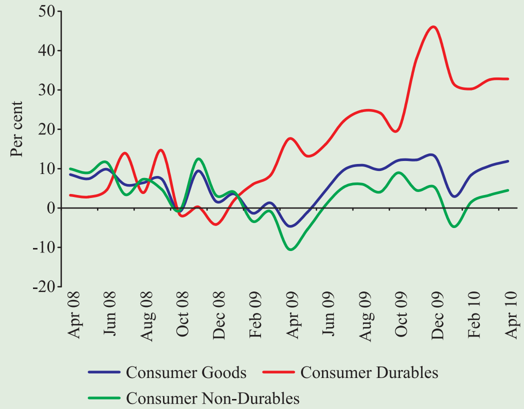
Chart I.2: Food Stock and its Determinants



Note: 1. Off-take is indicated as an outflow from stocks.
2 .Data for off-take are available up to April 2010 and for procurement up to July 19, 2010.
3. Procurement and off take figures are cumulative totals.

Chart I.4: Drivers of Manufacturing Growth (y-o-y growth)





weakness in global demand which may cause some moderation in the pace of growth, industrial activities could be expected to remain buoyant.

I.7 The manufacturing sector growth is getting more broad-based. Five top manufacturing industries, with a combined weight of 24.6 per cent in IIP, grew at 19.3 per cent, contributing about 63.5 per cent of the total growth during 2009-10 as compared with 134.6 per cent in the previous year. However, during April-May 2010, top five manufacturing industries with a combined weight of 24.6 per cent in IIP, grew at 32 per cent, contributing 73.4 per cent. (Chart I.5).

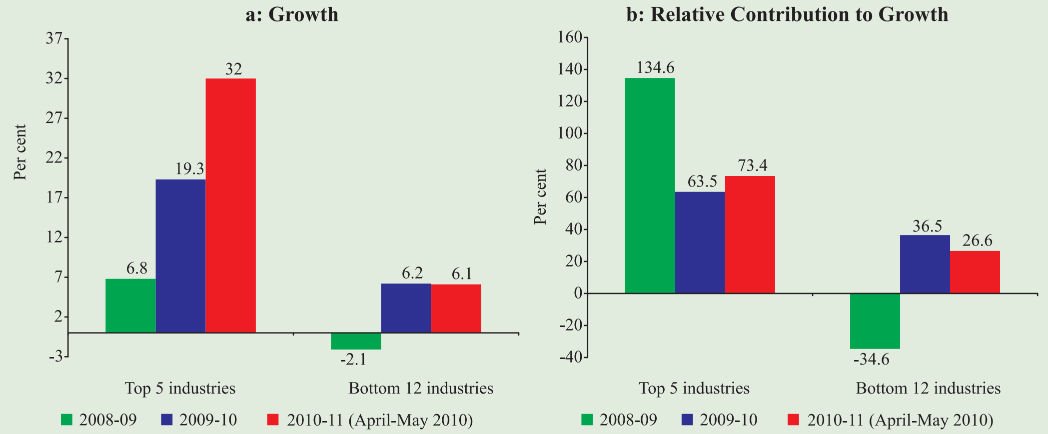
Table I.3: Index of Industrial Production: Sectoral and Use-based Classification of Industries

(Per cent)

Industry Group	Weight in the IIP	Growth Rate			Weighted Contribution #		
		April-March 2009-10	April-May		April-March 2009-10	April-May	
			2009-10	2010-11 P		2009-10	2010-11 P
1	2	3	4	5	6	7	8
Sectoral							
Mining	10.5	9.8	3.4	10.2	6.3	14.2	5.0
Manufacturing	79.4	10.9	1.1	15.1	88.9	59.3	91.0
Electricity	10.2	6.0	4.8	6.6	4.8	25.2	4.1
Use-Based							
Basic Goods	35.6	7.1	4.1	8.5	20.4	76.0	18.5
Capital Goods	9.3	19.2	-4.7	50.9	24.5	-33.1	38.7
Intermediate Goods	26.5	13.6	7.3	10.4	32.7	116.1	20.3
Consumer Goods (a+b)	28.7	7.3	-2.9	10.0	22.4	-59.3	22.7
a) Consumer Durables	5.4	26.2	15.3	28.1	19.4	70.1	16.8
b) Consumer Non-durables	23.3	1.3	-8.0	3.5	3.0	-129.1	5.8
General	**100.0**	**10.4**	**1.6**	**14.0**	**100.0**	**100.0**	**100.0**

P: Provisional. # : Figures may not add up to 100 due to rounding off.
Source: Central Statistical Organisation.

Chart I.5: Growth Concentration in the Manufacturing Sector



I.8 During the period April 2009-February 2010, capacity utilisation levels in the infrastructure sector showed a mixed trend. While finished steel and fertiliser sectors recorded higher utilisation as compared with the same period last year, cement and refinery production of petroleum sector witnessed lower utilisation for the same period (Table 1.4). The Order Books, Inventories and Capacity Utilisation Survey (OBICUS) of the Reserve Bank indicates that capacity utilisation, which was witnessing an improvement since Q2 of 2009-10, declined marginally in Q4 of 2009-10. The Industrial Outlook Survey (IOS) of the Reserve Bank also points to a similar pattern (Chart I.6). A part of the moderation in capacity utilisation could have resulted from the augmentation of capacity driven by the sharp acceleration in investment growth in the fourth quarter of 2009-10. Capacity utilisation rates, however, appear to be stretched in areas like import cargo and domestic passenger segment of the aviation sector.

I.9 The government has been monitoring the impact of the global crisis

Table I.4: Capacity Utilisation in Infrastructure Sector

		(Per cent)
Sector	(April-February)	
	2008-09	2009-10
1	2	3
Finished Steel (SAIL+VSP+ Tata Steel)	85.9	89.3
Cement	86.0	83.0
Fertiliser	83.3	94.7
Refinery Production–Petroleum	107.7	107.3

Source: Capsule Report on Infrastructure Sector Performance (April 2009-Febraury 2010), MOSPI, GoI

Chart I.6: Capacity Utilisation

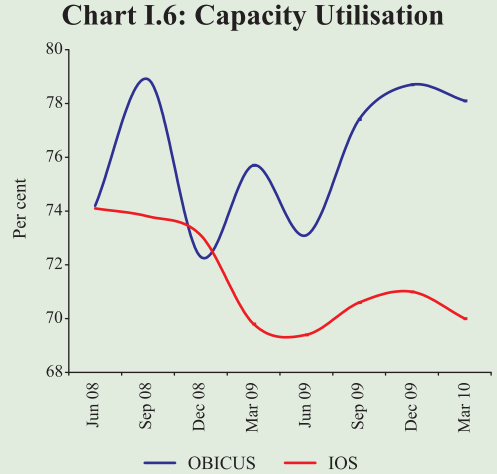


Table I.5: Changes in Estimated Employment

(in lakh)

Industry/Group	June 2009 Over March 2009	September 2009 Over June 2009	December 2009 Over September 2009	March 2010 Over December 2009	March 2010 Over March 2009
1	2	3	4	5	6
1. Textiles including apparels	-1.54	3.18	0.16	-1.19	0.61
2. Leather	0.07	-0.08	0.09	0.00	0.08
3. Metals	-0.01	0.65	0.23	0.04	0.91
4. Automobiles	0.23	0.24	0.06	0.29	0.82
5. Gems and jewellery	-0.20	0.58	0.07	0.24	0.69
6. Transport	-0.01	0.00	-0.02	-0.02	-0.05
7. IT/BPO	-0.34	0.26	5.70	1.29	6.91
8. Handloom / Powerloom	0.49	0.15	0.09	-0.05	0.68
Overall	**-1.31**	**4.98**	**6.38**	**0.61**	**10.66**

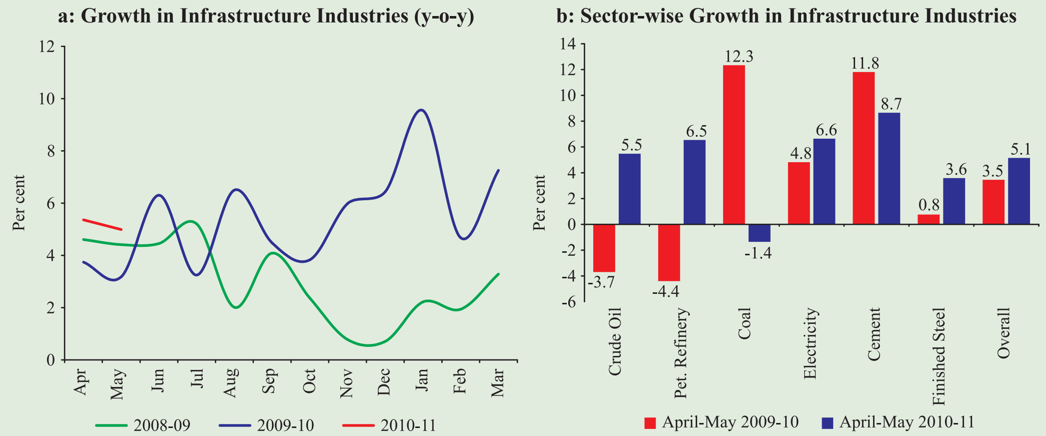
Source: Sixth Quarterly Quick Employment Survey, December 2009-March 2010, Labour Bureau.

on employment through quarterly surveys. Even though a decline was observed during the first quarter of 2009-10, the employment situation improved in the next two quarters and showed a marginal rise in the last quarter of 2009-10 (Table I.5).

Infrastructure

I.10 The six core industries registered a growth of 5.1 per cent during April-May 2010-11 as against 3.5 per cent during the same period in 2009-10 (Chart I.7a and b). The growth in the infrastructure sector during the year so far has come largely from electricity, steel, crude and petroleum refinery sectors while the growth in cement production was subdued and that of coal production was negative. In recent months, the pace of infrastructure growth has lagged behind the pace of industrial growth, which will further widen the infrastructure gap.

Chart I.7: Growth in Infrastructure Industries



I.11 Natural gas production, which is not reflected in the core infrastructure index, increased sharply during 2009-10 on account of commencement of production from the D6 block in Krishna-Godavari (KG) basin and Rajasthan fields (Cairn). Natural gas production witnessed a sharp growth of 44.8 per cent in 2009-10 as compared with 1.4 per cent in 2008-09. Gas production increased by 43.5 per cent in April-May 2010 as compared with 11.7 per cent in the same period last year.

Services Sector

I.12 The services sector rebounded in Q4:2009-10 after some moderation in the previous quarter (Chart I.8). While the growth in the segment related to manufacturing *viz.*, 'construction' and "trade, hotel, transports and communication" accelerated, the "financing, insurance, real estate and business services" segment remained steady. Excluding "community, social and personal services", services sector reached closer to the growth trajectory that was achieved prior to the global crisis.

I.13 Data on a number of lead indicators of services sector activities like tourist arrivals, commercial vehicles production and railway freight traffic suggest continuation of the buoyancy in 2010-11 (Table I.6).

I.14 To sum up, GDP growth in the last quarter of 2009-10 was higher than previously expected, and going by the lead indicators, this growth rate seems sustainable. On the supply side, the agriculture and allied sector is expected to post a better performance than last year. Continuing resilience of the services sector, coupled with buoyancy of the industrial sector would lend further support to this growth momentum. Demand side factors like revival of private consumption demand and pick-up in private investment are expected to offset the slowdown in government consumption due to the gradual exit from the fiscal stimulus measures.

I.15 While the pick-up in investment is already significant, going forward, the sustainability of current buoyancy in

Chart I.8: Trends in Quarterly Growth of Services Sector

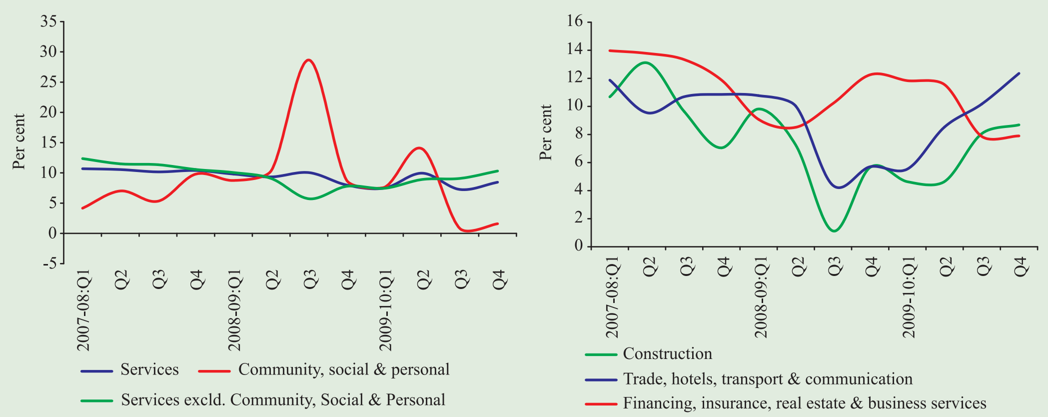


Table I.6: Indicators of Services Sector Activity

(Growth in Per cent)

Indicators	2007-08	2008-09	2009-10	2009-10 (April-June)	2010-11 (April-June)
1	2	3	4	5	6
Tourist arrivals	12.2	-3.3	3.5	-1.9	8.4
Commercial vehicles production	4.8	-24.0	58.9	-18.5	57.1
Cement#	8.1	7.2	10.5	11.8	8.7
Steel#	6.2	1.6	4.9	0.8	4.7
Railway revenue earning freight traffic	9.0	4.9	6.6	5.1	8.3
Cell phone connections##	38.3	80.9	47.3	83.5	42.0
Cargo handled at major ports##	12.0	2.2	5.7	-1.2	2.7
Civil aviation					
Export cargo handled##	7.5	3.4	10.4	0.7	13.1
Import cargo handled##	19.7	-5.7	7.9	-17.2	29.9
Passengers handled at international terminals##	11.9	3.8	5.7	0.4	6.9
Passengers handled at domestic terminals##	20.6	-12.1	14.5	-17.1	27.0

: Data pertain to April-May.

: Data up to April.

Source: Ministry of Tourism; Ministry of Commerce and Industry; Ministry of Statistics and Programme Implementation; Reserve Bank of India.

industrial and services growth would require large additions to capacity. The possibility of crowding-out pressures has reduced after the better than expected collections through 3G/BWA spectrum auctions. However, risks to growth could arise from inflation and uncertainties on the external front.

II. AGGREGATE DEMAND

Drivers of aggregate demand changed significantly in the fourth quarter of 2009-10, suggesting increasing self-sustaining nature of the recovery process. The recovery in investment demand exhibited acceleration, which seems to have been sustained in 2010-11 so far, going by the trends in capital goods production. Private consumption demand remained subdued, though lead indicators suggest pick-up in recent months. Contribution of government consumption demand has moderated considerably and reflecting the fiscal consolidation process, the support from government spending is expected to moderate further. The positive contribution of net exports that resulted from sharper decline in imports in relation to exports during 2009-10 will revert to the normal pattern in 2010-11 as domestic demand picks up. The overall growth outlook, thus, would be largely conditioned by the strength of private consumption and investment demand in 2010-11.

Domestic Demand

II.1 Private consumption and investment demand had turned anaemic in the wake of the global crisis, which necessitated demand stimulating monetary and fiscal measures. Self-sustaining drivers of growth from the demand side, particularly private investment demand, exhibited a turnaround in the second half of 2009-10, which also facilitated the beginning of policy exit. With continuation of the recovery in private investment demand and stronger pick-up in private consumption demand, normalisation of monetary policy and fiscal consolidation would create the macro-economic environment that would be conducive for sustainable high growth.

II.2 The evolving trends in aggregate demand provide useful insights into the major drivers of growth momentum and their sustainability over the medium-term. The growth in private consumption demand witnessed deceleration from 6.8 per cent in 2008-09 to 4.3 percent in 2009-10, reflecting the dampening impact of overall economic slowdown on the one hand and weak agriculture production and high food prices on the other. The slowdown in private consumption demand was particularly sharp during the fourth quarter of 2009-10 (Table II.1 and Chart II.1).

II.3 The government final consumption expenditure, which had emerged as the dominant driver of growth in the third quarter of 2008-09, witnessed significant moderation starting from the third quarter of 2009-10. The slowdown in government consumption expenditure continued through the fourth quarter of 2009-10, reflecting the high base in the second half of the previous year owing to the crisis induced fiscal stimulus. The sluggish growth in both private and government consumption demand has led to moderation in their respective contributions to growth in aggregate demand during the fourth quarter of 2009-10 (Chart II.2).

Table II.1: Expenditure Side of GDP (At 2004-05 Prices)

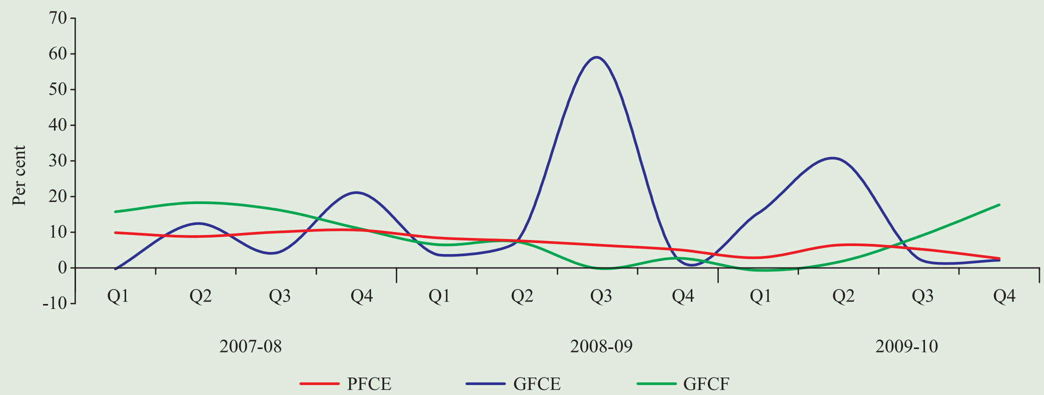
(Per cent)

Item	2008-09*	2009-10#	2008-09				2009-10			
			Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
1	2	3	4	5	6	7	8	9	10	11
Growth Rates										
Real GDP at market prices	5.1	7.7	7.3	6.9	3.0	3.8	5.2	6.4	7.3	11.2
Total Consumption Expenditure	8.3	5.3	7.7	7.6	13.2	4.6	4.7	9.6	4.8	2.6
(i) Private	6.8	4.3	8.4	7.6	6.4	5.1	2.9	6.4	5.3	2.6
(ii) Government	16.7	10.5	3.7	7.5	59.0	2.5	15.3	30.5	2.5	2.1
Gross Fixed Capital Formation	4.0	7.2	6.5	7.3	-0.1	2.7	-0.7	1.6	8.8	17.7
Change in Stocks	-61.2	5.9	-60.2	-60.3	-61.9	-62.2	-0.9	4.2	8.7	11.1
Net Exports	40.2	-9.7	31.1	101.0	77.7	-29.4	29.8	6.1	-0.3	-113.4
Relative Shares										
Total Consumption Expenditure	70.9	69.4	71.8	69.4	75.2	67.5	71.4	71.5	73.4	62.3
(i) Private	59.5	57.6	61.3	60.1	61.5	55.4	59.9	60.1	60.4	51.1
(ii) Government	11.5	11.8	10.5	9.2	13.7	12.2	11.5	11.3	13.1	11.2
Gross Fixed Capital Formation	32.9	32.8	33.0	34.8	31.5	32.7	31.2	33.2	31.9	34.6
Change in Stocks	1.3	1.3	1.4	1.4	1.3	1.3	1.3	1.4	1.3	1.3
Net Exports	-6.1	-5.1	-5.2	-8.8	-7.3	-3.5	-6.5	-8.7	-6.7	0.4

*: Quick Estimates.   # : Revised Estimates.

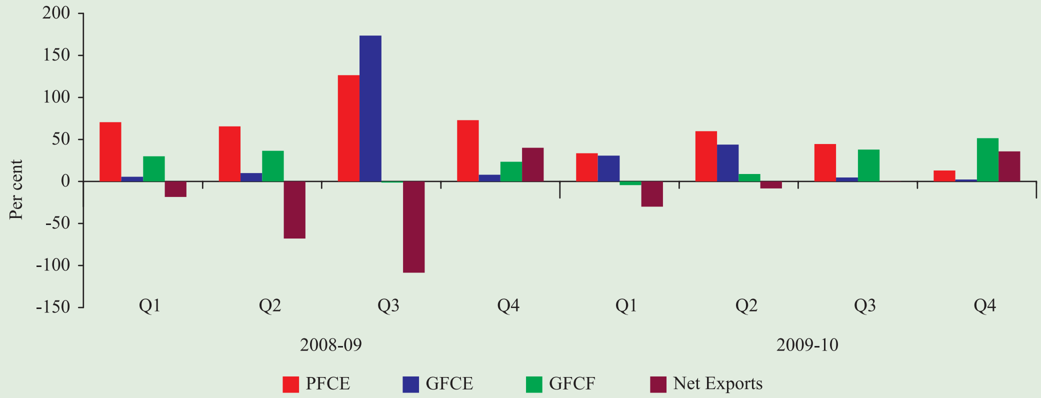
II.4 The y-o-y growth in gross fixed capital formation during the fourth quarter of 2009-10 at 17.7 per cent represented a significant acceleration. Consequently, the contribution of investment demand to growth improved substantially to 51.5 per cent during the fourth quarter of 2009-10 as against 38.0 per cent in the preceding quarter. The pick- up in investment demand was reflective of improved overall business and investment environment and intentions to add capacity to meet the expected pick-up in demand. In addition to the fixed investment activity, there were indications of rapid inventory build up during the third and fourth quarters of 2009-10.

Chart II.1: Growth Rate of Major Components of Domestic Demand



PFCE: Private Final Consumption Expenditure. GFCE: Government Final Consumption Expenditure. GFCF: Gross Fixed Capital Formation.

Chart II.2: Weighted Contribution to GDP Growth from Demand Side



PFCE: Private Final Consumption Expenditure. GFCE: Government Final Consumption Expenditure. GFCF: Gross Fixed Capital Formation.

Demand Management through Fiscal Policy

Central Government Finances: 2009-10 and 2010-11

II.5 With a view to supporting the recovery momentum, fiscal policy continued its expansionary stance during 2009-10. Reflecting this, the revenue deficit (RD) and gross fiscal deficit (GFD) expanded over the previous year (RE) (Table II.2).

II.6 With gradual exit from the fiscal stimulus measures through the partial rollback of indirect tax cuts and compression in the growth of non-plan expenditure, the Central Government

Table II.2: Key Fiscal Indicators

(Per cent to GDP)

Year	Primary Deficit	Revenue Deficit	Gross Fiscal Deficit	Outstanding Liabilities
1	2	3	4	5
		Centre		
2008-09 (Actual)	2.6	4.5	6.0	56.7
2009-10 RE	3.1	5.3	6.6	56.4
2010-11 BE	1.9	4.0	5.5	56.9
		States*		
2008-09 (Actual)	0.6	-0.2	2.4	26.2
2009-10 RE	1.7	1.0	3.6	26.3
2010-11 BE	1.2	0.6	3.0	–
		Combined		
2008-09 (Actual)	3.4	4.4	8.5	71.6
2009-10 RE	4.9	6.2	10.1	72.4
2010-11 BE	3.2	4.6	8.5	–

RE : Revised Estimates. BE : Budget Estimates.
* : Based on Budget documents of 24 State Governments.
– : Not available.
Note: Minus sign against deficit parameters indicates surplus.

resumed the process of fiscal consolidation during 2010-11. With these measures, alongside the expected higher growth in GDP, RD and GFD are envisaged to be brought down during 2010-11(BE) over the preceding year.

II.7 The correction in deficit indicators has been envisaged in the Union Budget for 2010-11 to come through a combination of factors, *viz.*, higher revenue receipts, greater disinvestment proceeds, and curtailment of growth in revenue expenditure, especially in the non-plan component (Table II.3). Revenue collections from 3G/BWA spectrum auctions have turned out to be Rs.1,06,262 crore, more than three times of the budgeted amount of Rs.35,000 crore in the Union Budget for 2010-11. As a result, the non-tax revenue receipts are expected to go up by 48 per cent from the budgeted level. This additional mobilisation of resources, unless utilised for expanding expenditure, would result in an additional 1.0 percentage point reduction in both RD and GFD, compared to what has been envisaged in the Budget estimates of 2010-11, and thereby create more space for private investment. The decision taken in June 2010 to deregulate petrol prices and revise the prices of other petroleum products upwards would also help in containing the pressure on the fiscal situation, besides contributing to medium-term fiscal sustainability. Some of the tax measures announced in the Union Budget for 2010-11, such as increase in income tax slabs and the indirect tax measures, *viz.*, concessional customs duty, exemption of excise duty and service tax would have positive impact on the private consumption and investment demand. Direct tax collections during April-June 2010 have registered strong growth reflecting, *inter-alia*, the rebound in economic activity.

State Finances

II.8 With a view to encouraging the State governments to undertake additional capital investments and boost domestic aggregate demand, States were allowed additional market borrowing to the extent of 0.5 per cent of their GSDP in 2008-09 and further 0.5 per cent in 2009-10. Consequently, there was significant increase in aggregate

Table II.3: Central Government Finances

Item	Growth rate (per cent)			Per cent to GDP		
	2008-09	2009-10 (RE)	2010-11 (BE)	2008-09	2009-10 (RE)	2010-11 (BE)
1	2	3	4	5	6	7
1. Total Expenditure	24.0	15.6	8.5	15.9	16.4	16.0
2. Revenue Expenditure	33.5	14.2	5.8	14.2	14.5	13.8
3. Capital Expenditure	-23.7*	27.8	30.2	1.6	1.8	2.2
4. Non-Plan Expenditure	19.9	16.0	4.1	10.9	11.3	10.6
5. Plan Expenditure	34.2	14.5	18.4	4.9	5.1	5.4
6 .Revenue Receipts	-0.3	6.9	18.2	9.7	9.3	9.8
i) Tax Revenue (net)	0.9	4.9	14.8	8.0	7.5	7.7
ii) Non Tax Revenue	-5.3	15.7	32.0	1.7	1.8	2.1

RE : Revised Estimates. BE : Budget Estimates.

* : The sharp decline essentially reflects the higher base of the previous year (2007-08), on account of acquisition of the RBI's stake in the State Bank of India by the Government of India.

spending of the State governments in 2009-10 (RE), resulting in higher deficit. In terms of the budget documents for 2010-11, the State governments have resumed the process of fiscal consolidation.[1] Correction in deficit indicators is expected to be achieved mainly through significant moderation in the growth of revenue expenditure from 25.2 per cent in 2009-10 (RE) to 9.6 per cent in 2010-11 (BE), while the deceleration in the growth of capital outlay from 11.4 per cent to 3.8 per cent during the same period is also expected to aid the process. This would be supplemented by 16.6 per cent growth in own tax revenues and 19.9 per cent growth in States' share in central taxes in 2010-11 (BE). As a result, States' revenue deficit and gross fiscal deficit are budgeted to be lower in 2010-11 (BE).

Combined Fiscal Position

II.9 Reflecting the continued expansionary fiscal stance of both the Central and State Governments, the combined RD increased to 6.2 per cent, while GFD rose to 10.1 per cent of GDP during 2009-10. The combined finances are likely to improve considerably during 2010-11, on account of the envisaged path of fiscal consolidation by both the Centre and the States (Table II.4).

Corporate Performance

II.10 The pick-up in overall economic activity was evident from the corporate sales data as well. During the fourth quarter of 2009-10, the year-on-year sales growth of select non-financial non-government listed companies was around 29 per cent, which turned out to be the highest in last six quarters (Table II.5). Net profits also increased by 44 per cent as against a sharp decline during the corresponding period of the preceding year. The increase largely emanated from manufacturing companies. The improved revenue realisation reflects besides a low base, strong recovery in economic activity and rising commodity prices. The profit margins also continued to be supported by rise in other income and

Table II.4: Combined Finances

Item	Growth rate (per cent)			Per cent to GDP		
	2008-09	2009-10 (RE)	2010-11 (BE)	2008-09	2009-10 (RE)	2010-11 (BE)
1	2	3	4	5	6	7
1. Total expenditure	20.4	19.6	8.4	28.4	30.4	29.6
2. Revenue Expenditure	25.7	20.0	7.4	24.2	25.9	25.0
3. Capital Expenditure	-3.0	17.4	13.9	4.3	4.5	4.6
4. Non-Developmental Expenditure	7.1	22.5	11.2	11.3	12.4	12.4
5. Development expenditure	31.5	17.8	6.1	16.8	17.7	16.8
6. Revenue Receipts	3.9	11.4	15.6	19.8	19.7	20.5
i) Tax Revenue	5.2	7.5	16.3	16.6	15.9	16.7
ii) Non Tax Revenue	-2.6	31.1	12.3	3.2	3.8	3.8

RE : Revised Estimate. BE : Budget Estimate.

Note: The data pertains to the Central Government and 24 State Governments.

[1] Based on the budget documents of twenty-four State governments.

Table II.5: Performance of Non-Government Non-Financial Listed Companies

(Growth rate/ratios in per cent)

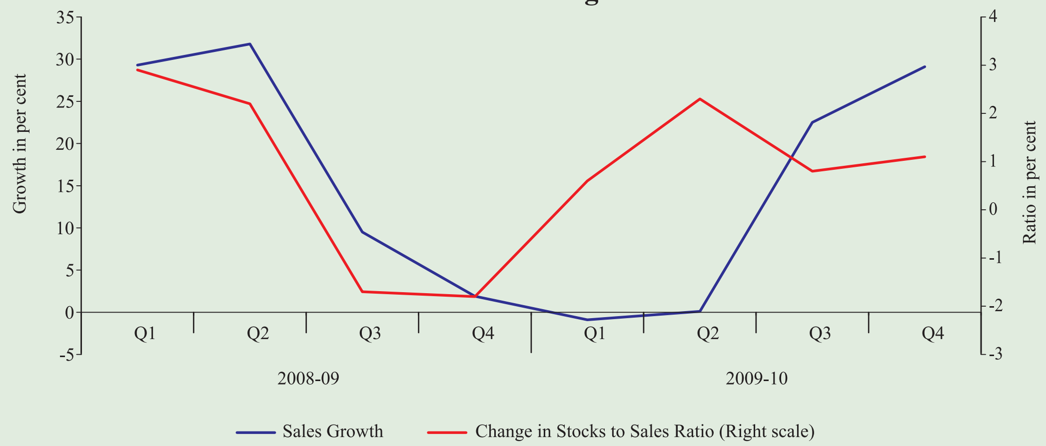
Item	2008-09	2009-10	2008-09				2009-10			
			Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
1	2	3	4	5	6	7	8	9	10	11
Sales	17.2	11.7	29.3	31.8	9.5	1.9	-0.9	0.1	22.5	29.1
Other Income*	6.6	6.3	-8.4	-0.6	-4.8	39.4	50.2	6.0	7.4	10.3
Expenditure	19.5	9.6	33.5	37.5	12.6	-0.5	-4.4	-2.5	20.6	30.7
Depreciation provision	17.4	22.2	15.3	16.5	16.8	19.6	21.5	20.7	21.6	20.1
Gross profits	-4.2	24.9	11.9	8.7	-26.7	-8.8	5.8	10.9	60.0	36.7
Interest payments	57.3	-3.2	58.1	85.3	62.9	36.5	3.7	-1.0	-12.3	-2.9
Profits after tax	-18.4	28.8	6.9	-2.6	-53.4	-19.9	5.5	12.0	99.3	44.0
Select Ratios										
Change in Stock# to Sales	0.4	1.0	2.9	2.2	-1.7	-1.8	0.6	2.3	0.8	1.1
Gross Profits to Sales	13.3	14.8	14.5	13.5	11.0	13.7	15.7	14.9	14.3	14.6
Profits After Tax to Sales	8.1	9.4	9.7	8.6	5.3	8.1	10.2	9.4	8.8	9.0
Interest to Sales	3.1	2.7	2.4	2.9	3.8	3.2	2.8	3.1	2.7	2.4
Interest to Gross Profits	23.6	18.2	16.8	21.5	34.6	23.3	18.0	20.5	19.1	16.6
Interest Coverage (Times)	4.2	5.5	6.0	4.6	2.9	4.3	5.6	4.9	5.2	6.0

* : Other income excludes extraordinary income/expenditure if reported explicitly.
\# : For companies reporting change in stock-in-trade explicitly.
Note: 1. Growth rates are year-on-year percentage changes for common set of companies.
2. Quarterly data may not add up to annual data due to differences in number and composition of sample covered in each period.

the decline in interest outgo. During the fourth quarter of 2009-10, both sales and inventory demand have gone up, suggesting acceleration in industrial activity (Chart II.3).

II.11 Sequentially, seasonally adjusted sales recorded improvement in the first three quarters of 2009-10, but decelerated in the fourth quarter. Project finance data from major banks/financial institutions

Chart II.3: Sales Growth and Change in Stocks to Sales Ratio



suggested the improved strength in private corporate sector's investment intentions.

External Demand

II.12 Net exports (of goods and services, at constant prices) contributed positively by 7.8 per cent to GDP growth in the demand side during 2009-10, as against a negative contribution of around 36.2 per cent in 2008-09. The positive contribution of net exports, contrary to the normal trend in the past, emanated from the relatively larger decline in imports than exports during the year. During the fourth quarter of 2009-10, contribution of net exports increased further as exports increased by 14.2 per cent, while imports declined by 3.7 per cent (see Chart II.2). Merchandise trade data for April-June 2010 suggest higher growth in imports than exports. Thus, the positive contribution of net exports can be expected to reverse in 2010-11. A detailed discussion on the external demand conditions is set out in Chapter III.

II.13 To sum up, investment demand has showed a robust turnaround, which is expected to continue as suggested by the production trends in capital goods, non-oil imports and corporate profits. While private consumption demand was subdued in 2009-10, trends in corporate sales, production of consumer durables and non-durables and automobile sales point to significant pick-up in private consumption demand in recent months. The contribution of net exports to aggregate demand, however, will turn negative, reflecting higher import demand.

III. THE EXTERNAL ECONOMY

With recovery in export growth in the second half and revival in capital inflows, the external sector of the economy improved during 2009-10. The current account deficit, however, widened to 2.9 per cent of GDP, primarily due to lower surplus in the invisibles account. Through better absorption of foreign capital, the higher current account deficit contributed to the recovery in growth. Gross external debt and net international liabilities of the country increased during the year. The debt sustainability indicators, however, continued to remain comfortable. As on July 16, 2010, the foreign exchange reserves stood at US$ 281.9 billion.

International Developments

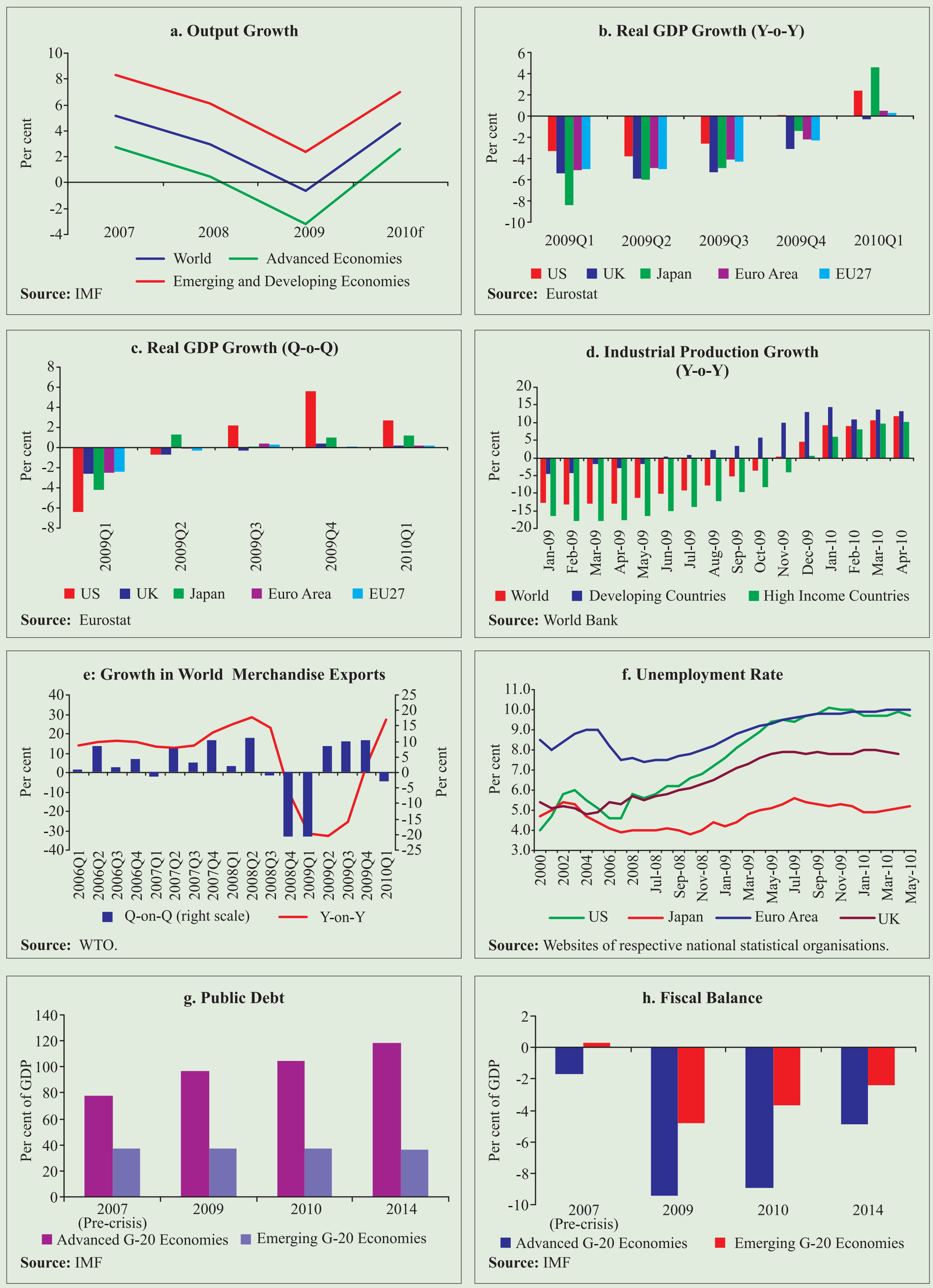
III.1 The global economy witnessed a robust recovery in the first quarter of 2010 before encountering heightened downside risks stemming from concerns relating to sovereign debt sustainability in several European countries. The uncertainty about the fiscal stress spreading from the "periphery" countries to the "core" in the euro area and even to other advanced economies led to significant erosion in risk appetite which was reflected in flight to safety, greater volatility in markets, and tighter financing conditions.

III.2 Taking into account the strong 5.1 per cent growth in global output in the first quarter of 2010, in July 2010, the IMF revised its growth projections upwards for 2010 to 4.6 per cent from 4.2 per cent earlier (Chart III.1a). The pace and the drivers of growth are expected to remain divergent across countries. The emerging and developing economies are projected to grow by 6.8 per cent, led by China and India, as against 2.6 per cent growth projected for advanced economies. In the euro area, the impact of tighter financing conditions on growth is expected to be significantly offset by the positive effects of euro depreciation.

III.3 The advanced economies, which exhibited both year-on-year and sequential quarter-on-quarter recovery in the first quarter of 2010, face the major downside risk in the form of pressures from the markets to reverse fiscal expansion (Chart III.1b and c). Recovery in industrial production, however, continues (Chart III.1d). The global composite Purchasing Managers' Index (PMI) moderated somewhat in May and June 2010 as compared to its 34-month high level in April 2010, though it remained higher than its average level in 2009.

III.4 The improving demand conditions have helped in the recovery of world trade, which grew by about 25 per cent in value terms, on a year-on-year basis, during the first quarter of 2010. According to the IMF, exports of emerging and developing economies have witnessed higher growth than those of advanced economies in recent months. Despite the high growth, the global export performance is yet to reach its pre-crisis level. In fact, world exports declined by 3.0 per cent, on a quarter-on-quarter basis (Chart III.1e). For the year as a whole, the IMF projects world trade (in goods and services) to grow by 9 per cent as against 11.3 per cent decline in 2009.

Chart III.1: Key Global Indicators



III.5 In a recent joint report on G-20 trade and investment measures, the WTO, OECD and UNCTAD noted the importance of trade and investment to firmly anchor the economic recovery. Several countries continue to impose new trade restrictions, though there has been a decline in the number of new measures. According to the WTO, the new import restricting measures introduced during November 2009-May 2010 (along with new initiations of investigations into the imposition of trade remedy measures) cover close to 0.4 per cent of annual world imports as compared with 1.0 per cent during October 2008-October 2009. There has also been an increase in export restrictions worldwide in the form of introduction of new export duties, prohibitions, and export quotas. Economic conditions around the world, in particular persistent high levels of unemployment and mounting pressure on government finances, may continue to feed protectionist pressures. Unemployment rates in advanced economies remain high though there is evidence of stabilisation/ some decline in recent months (Chart III.1f). High fiscal stress levels of advanced economies is a potential risk to the global economy. If fiscal austerity is implemented to restore market normalcy, it could impede recovery. On the other hand, if the fiscal stress is allowed to continue to avoid weakening of recovery, adverse market response could add further volatility (Chart III.1g and h).

III.6 According to the IMF, capital flows to EMEs could initially decline because of waning risk appetite of global investors. The World Bank's recent assessment also suggests that capital inflows to developing countries could moderate on the back of increased competition for global savings from a five-fold increase in public sector financial requirements in high income countries. Because of higher growth prospects, lower public debt and monetary exit ahead of advanced economies, EMEs will, however, attract larger capital inflow in the later part of the year, which in turn could exert pressures on exchange rate and asset prices.

III.7 The external environment, thus, suggests that India's import growth could exceed its export growth because of the asymmetry in the speed of GDP growth between India and the global economy. As a result, possible widening of current account deficit may also require higher net inflows of foreign capital, which could remain volatile in a global market where risk appetite of investors may take some time to recover.

Merchandise Trade

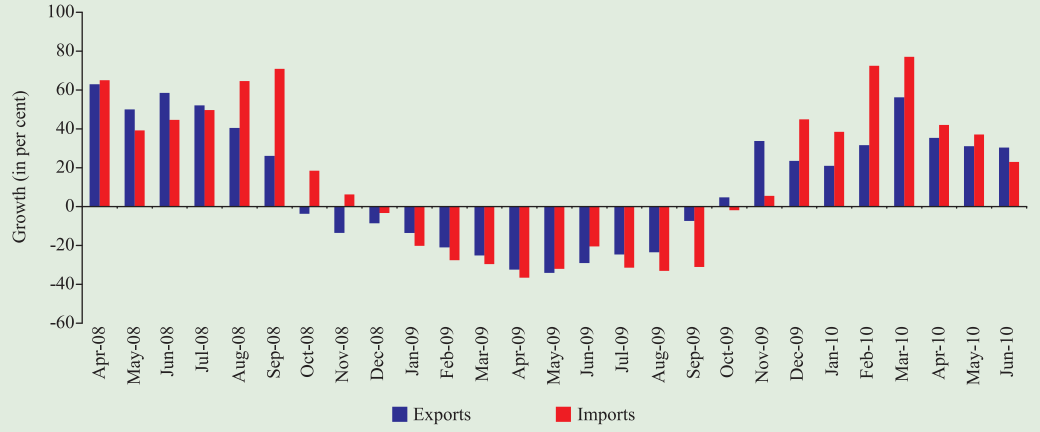
Exports

III.8 India's exports, which contracted sharply in the wake of the crisis, have exhibited positive growth since October 2009 (Chart III.2).

Imports

III.9 Imports too, which were hit by the crisis, have recovered sharply with high positive growth since November 2009. For the full year 2009-10, however, there was a net decline in imports. Oil and non-oil

Chart III.2: India's Merchandise Trade



imports registered a decline of 7.0 per cent and 4.9 per cent, respectively, during 2009-10 (Chart III.3 and Table III.1).

III.10 The overall merchandise trade deficit during 2009-10 was at US$ 108 billion, down from US$ 118 billion in 2008-09, due to relatively larger decline in imports than exports during the year (Table III.1). In the first quarter of 2010-11, import growth, however, has exceeded export growth.

Balance of Payments (BoP)

Current Account

III.11 The deficit in the current account expanded to 2.9 per cent of GDP in 2009-10 from 2.4 per cent of GDP in 2008-09. In absolute terms, current account deficit rose in both quarters of the second half of 2009-10 over the quarters in the first half of the year, which coincided with stronger domestic recovery in growth,

Chart III.3: India's POL Imports and International Crude Oil Prices

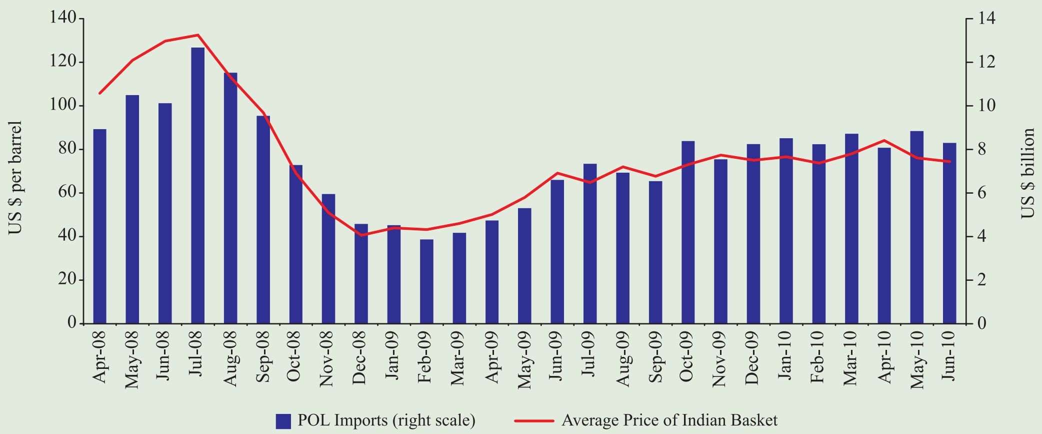


Table III.1: India's Merchandise Trade

Item	April-March 2009-10 P Absolute (US$ billion)	April-March 2009-10 P Growth (%)	April-May 2009-10 R Absolute (US$ billion)	April-May 2009-10 R Growth (%)	April-May 2010-11 P Absolute (US$ billion)	April-May 2010-11 P Growth (%)
1	2	3	4	5	6	7
Exports	178.7	-3.6	24.8	-33.3	33.0	33.2
Oil	28.1	2.1	3.0	-45.9	..	..
Non-oil	150.5	-4.6	21.8	-31.0	..	..
Imports	286.8	-5.6	39.2	-34.3	54.7	39.5
Oil	87.1	-7.0	10.0	-48.3	16.9	68.5
Non-oil	199.7	-4.9	29.2	-27.6	37.8	29.6
Trade Balance	**-108.2**	**-8.6**	**-14.4**	**-36.1**	**-21.7**	**50.3**
Non-Oil Trade Balance	**-49.2**	**-5.9**	**-7.4**	**-15.3**	**..**	**..**

R: Revised. P: Provisional. .. Not Available.
Source: DGCI&S.

ahead of the global recovery (Table III.2). The merchandise trade deficit in 2009-10 at US$ 117.3 billion was similar to US$ 118.7 billion in 2008-09. As percentage of GDP, however, the trade deficit was lower at 8.9 per cent in 2009-10 as compared with 9.8 per cent in 2008-09. The wider deficit in the current account, thus, resulted from lower surplus in the invisibles account.

Table III.2: India's Balance of Payments

(US$ billion)

	2008-09 Apr-Mar PR	2009-10 Apr-Mar P	2008-09 Jan-Mar PR	2009-10 Apr-Jun PR	2009-10 Jul-Sep PR	2009-10 Oct-Dec PR	2009-10 Jan-Mar P
1	2	3	4	5	6	7	8
1. Exports	189.0	182.2	38.5	39.2	43.5	47.1	52.4
2. Imports	307.7	299.5	58.7	64.8	72.6	78.1	83.9
3. Trade Balance (1-2)	-118.7	-117.3	-20.2	-25.6	-29.1	-31.1	-31.5
4. Net Invisibles	89.9	78.9	19.0	21.2	20.4	18.9	18.5
5. Current Account Balance (3+4)	-28.7	-38.4	-1.2	-4.5	-8.8	-12.2	-13.0
6. Gross Capital Inflows	312.4	344.0	59.4	77.1	95.4	81.3	90.2
7. Gross Capital Outflows	305.2	290.4	58.0	73.1	76.6	66.6	74.1
8. Net Capital Account (6-7)	7.2	53.6	1.4	4.0	18.8	14.7	16.1
9. Overall Balance (5+8)#	-20.1	13.4	0.3	0.1	9.4	1.8	2.1
Memo:							
i. Export growth (%)	13.7	-3.6	-20.0	-31.8	-18.9	19.3	36.2
ii. Import growth (%)	19.4	-2.7	-20.8	-21.7	-21.7	6.3	43.0
iii. Trade balance (as a % of GDP)	-9.8	-8.9					
iv. Net invisibles growth (%)	18.7	-12.2	-15.8	-3.7	-23.3	-15.6	-2.6
v. CAD as a % of GDP	2.4	2.9					
vi. Foreign Exchange Reserves (as at end of the period)	252.0	279.1	252.0	265.1	281.3	283.5	279.1

P: Preliminary. PR: Partially Revised. #: Includes errors and omissions. CAD: Current Account Deficit.

Invisibles

III.12 Invisibles surplus was lower at US$ 79 billion in 2009-10 (6.0 per cent of GDP) from US$ 90 billion in 2008-09, mainly due to decline in receipts under transportation, business, financial and communication services coupled with significant increase in payments of miscellaneous services such as business and financial services (Table III.3). During 2009-10, invisibles surplus financed 67.3 per cent of the trade deficit as against 75.8 per cent during 2008-09.

Capital Account

III.13 The surplus in the capital account increased during the fourth quarter of 2009-10 mainly due to large inflows under portfolio investments and short-term trade credits. However, net external commercial borrowings (ECBs) remained low, mainly due to increased repayments of commercial loans. Inflows under foreign direct investment witnessed some moderation. Banking capital registered net outflows on account of build-up of assets abroad by banks coupled with net outflows under NRI deposits. For the year as a whole, net capital flows were significantly higher (4.1 per cent of GDP) as compared with the previous year (0.6 per cent of GDP), mainly due to large inflows under FDI, portfolio investments and short-term trade credits (Table III.4 and Chart III.4).

III.14 Available information during 2010-11 so far shows some moderation in capital

Table III.3: Invisibles Gross Receipts and Payments

(US$ billion)

Item	Invisibles Receipts				Invisibles Payments			
	April-March		Jan-March		April-March		Jan-March	
	2008-09 PR	2009-10 P	2008-09 PR	2009-10 P	2008-09 PR	2009-10 P	2008-09 PR	2009-10 P
1	2	3	4	5	6	7	8	9
1. Travel	10.9	11.9	2.7	3.4	9.4	9.3	2.6	2.6
2. Transportation	11.3	11.1	2.9	3.1	12.8	11.9	2.5	3.6
3. Insurance	1.4	1.6	0.3	0.4	1.1	1.3	0.3	0.3
4. Govt. not included elsewhere	0.4	0.4	0.1	0.1	0.8	0.5	0.4	0.2
5. Miscellaneous	77.7	68.7	17.7	19.9	27.9	36.5	7.3	12.2
Of which:								
Software	46.3	49.7	10.8	14.3	2.8	1.5	0.5	0.3
Non-Software	31.4	19.0	6.9	5.6	25.1	35.0	6.8	11.9
6. Transfers	47.5	54.4	10.0	13.2	2.7	2.3	0.4	0.6
Of which								
Private Transfers	46.9	53.9	9.8	13.1	2.3	1.8	0.3	0.5
7. Income	14.3	13.0	3.4	2.7	18.8	20.4	4.6	4.8
Investment Income	13.5	12.1	3.2	2.5	17.5	18.7	4.3	4.3
Compensation of Employees	0.8	0.9	0.2	0.2	1.3	1.7	0.3	0.5
Total (1 to 7)	**163.5**	**161.2**	**37.1**	**42.8**	**73.6**	**82.3**	**18.1**	**24.4**

P: Preliminary. PR: Partially Revised.

Table III.4: Net Capital Flows

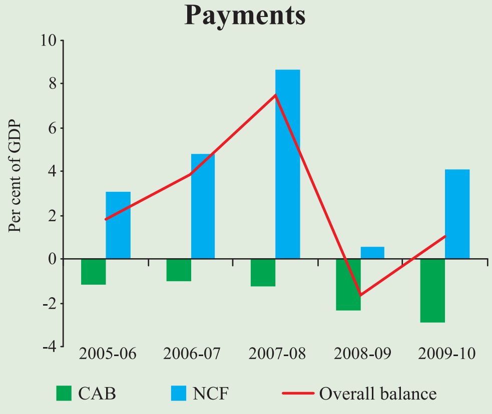
(US$ billion)

	2008-09 Apr-Mar PR	2009-10 Apr-Mar P	2009-10 Apr-Jun PR	Jul-Sep PR	Oct-Dec PR	Jan-Mar P
1	2	3	4	5	6	7
1. Foreign Direct Investment (FDI)	17.5	19.7	6.1	6.5	3.9	3.2
Inward	35.0	31.7	8.7	10.7	7.1	5.1
Outward	17.5	12.0	2.6	4.2	3.2	1.9
2. Portfolio Investment	-14.0	32.4	8.3	9.7	5.7	8.8
Of which:						
FIIs	-15.0	29.0	8.2	7.0	5.3	8.5
ADR/GDRs	1.2	3.3	0.0	2.7	0.5	0.1
3. External Assistance	2.6	2.0	0.1	0.5	0.6	0.8
4. External Commercial Borrowings	7.9	2.5	-0.5	1.2	1.7	0.1
5. NRI Deposits	4.3	2.9	1.8	1.0	0.6	-0.6
6. Banking Capital excluding NRI Deposits	-7.5	-0.8	-5.2	3.3	1.3	-0.4
7. Short-term Trade Credits	-1.9	7.7	-1.5	0.8	3.3	5.0
8. Rupee Debt Service	-0.1	-0.1	–	–	–	-0.1
9. Other Capital	-1.5	-12.7	-5.2	-4.3	-2.4	-0.9
Total (1 to 9)	**7.2**	**53.6**	**4.0**	**18.8**	**14.7**	**16.1**

P: Preliminary. PR: Partially Revised. – : Negligible.

inflows (Table III.5). There has been a perceptible slowdown in net FII inflows and inflows under NRI deposits, but FDI to India remains stable reflecting the confidence of global investors in India's growth prospects.

Chart III.4: India's Balance of Payments



CAB: Current Account Balance. NCF: Net Capital Flows.

Table III.5: Recent Trends in Capital Flows

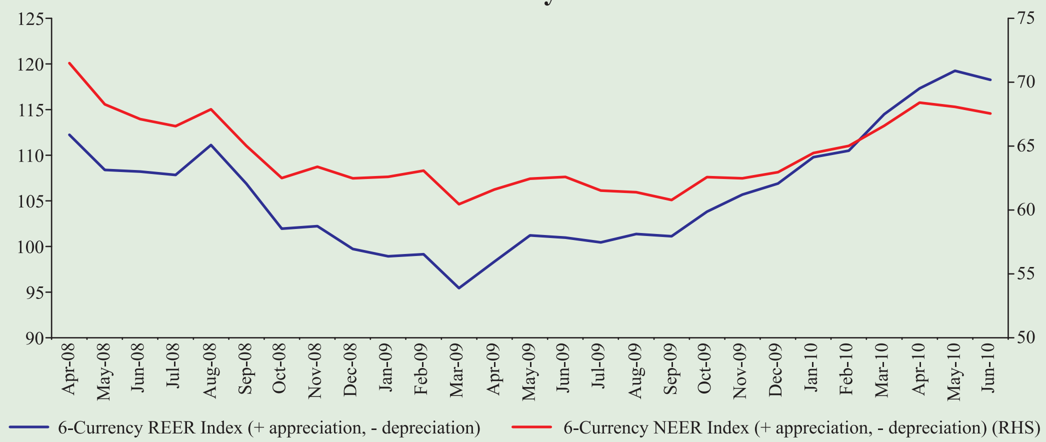
(US$ billion)

Component	Period	2009-10	2010-11
1	2	3	4
FDI to India	April-May	4.4	4.4
FIIs (net)	April - July 16	8.7	6.2
ADRs/GDRs	April-June	0.04	1.0
ECB Approvals	April-June	2.7	5.3
NRI Deposits (net)	April-June	1.8	1.3

FDI : Foreign Direct Investment.
FII : Foreign Institutional Investors.
ECB : External Commercial Borrowings.
NRI : Non Resident Indians.
ADR : American Depository Receipts.
GDR : Global Depository Receipts.

III.15 Notwithstanding some depreciation of the rupee against the US dollar in the first quarter of 2010-11 due to volatile portfolio flows, the appreciation of the real

Chart III.5: 6-Currency REER and NEER



effective exchange rate continued, reflecting high inflation differentials between India and its trading partners (Chart III.5 and Table III.6).

Foreign Exchange Reserves

III.16 During the year 2009-10, India's foreign exchange reserves, on a BoP basis (*i.e.*, excluding valuation effects), increased by US$ 13.4 billion as against a decline of US$ 20.1 billion during the previous year. The valuation gain, which reflects the depreciation of the US dollar against major international currencies, was about US$ 13.6 billion during 2009-10 as compared to a valuation loss of US$ 37.7 billion recorded during the previous year. Accordingly, the valuation gains alone accounted for about 50.4 per cent of the increase in the reserves during 2009-10. Including the valuation effects, India's foreign exchange reserves increased by US$ 27.1 billion during 2009-10 to reach the level of US$ 279.1 billion as at end-March 2010 (Table III.7 and Chart III.6). India's foreign exchange reserves stood at US$ 281.9 billion as on July 16, 2010.

Table III.6: Nominal and Real Effective Exchange Rates of the Indian Rupee (Trade Based Weights, Base : 1993-94 = 100)

(Per cent, appreciation + /depreciation -)

	Index June 2010 P	2008-09	2009-10 P	2009-10 (Apr-Jun) P	2010-11 (Apr-Jun) P
1	2	3	4	5	6
36-REER	101.2 [^]	-13.6	13.3	1.7 [#]	1.4 [#]
36-NEER	89.6 [^]	-10.3	9.3	4.6 [#]	1.5 [#]
6-REER	118.3	-14.0	20.0	5.8	3.3
6-NEER	67.6	-14.8	10.2	3.5	1.4
Rs/USD	47.1 [@]	-21.5	12.9	5.2 [*]	-4.2 [*]

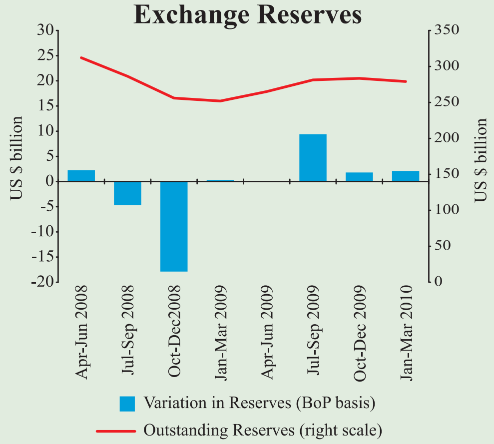
NEER : Nominal Effective Exchange Rate.
REER : Real Effective Exchange Rate. P: Provisional.
[#]: April-May. ^: May 2010. *: Up to July 20.
[@]: Rupee-US dollar exchange rate as on July 20, 2010
Note: Rise in indices indicates appreciation of the rupee and *vice versa.*

Table III.7: Foreign Exchange Reserves

(US$ million)

Month (End Period)	Gold	SDR	Foreign Currency Assets	Reserve Position in the IMF	Total (2+3+4+5)
1	2	3	4	5	6
March 2009	9,577	1	241,426	981	251,985
March 2010	17,986	5,006	254,685	1,380	279,057
July 16, 2010	19,894	4,987	255,677	1,343	281,901

Chart III.6: India's Foreign Exchange Reserves



External Debt

III.17 As at end March 2010, India's external debt stock stood at US$ 261.4 billion, an increase of US$ 36.9 billion over its level at end-March 2009. The increase was mainly on account of increase in long-term debt, such as external commercial borrowings, NRI deposits and SDR related liabilities (Table III.8). Of the total increase in India's external debt, the valuation effect on account of depreciation of the US dollar against major international currencies accounted for 17.8 per cent. Further, short-term debt was US$ 52.5 billion on original maturity basis and was US$ 107.6 billion on residual maturity basis. In terms of currency composition, the US dollar denominated debt accounted for 58.2 per cent of India's total external debt at end-March 2010. Key debt sustainability indicators suggest that India's external debt remain at comfortable level.

Table III.8: India's External Debt

(US$ billion)

Item	End-March 2008	End-March 2009 PR	End-March 2010 P	Variation (March 2010 over March 2009)	
				Amount	Per cent
1	2	3	4	5	6
1. Multilateral	39.5	39.5	42.7	3.2	8.1
2. Bilateral	19.7	20.6	22.6	2.0	9.6
3. International Monetary Fund	1.1	1.0	6.0	5.0	493.4
4. Trade Credit (above 1 year)	10.3	14.5	16.9	2.4	16.5
5. External Commercial Borrowings	62.3	62.4	71.0	8.6	13.7
6. NRI Deposit	43.7	41.6	48.1	6.5	15.7
7. Rupee Debt	2.0	1.5	1.6	0.1	8.5
8. Long-term (1 to 7)	178.7	181.2	209.0	27.8	15.4
9. Short-term	45.7	43.4	52.5	9.1	21.0
Total (8+9)	**224.4**	**224.5**	**261.4**	**36.9**	**16.5**
					(per cent)
Total Debt /GDP	18.1	20.5	18.9		
Short-term Debt/Total Debt	20.4	19.3	20.1		
Short-term Debt/Reserves	14.8	17.2	18.8		
Concessional Debt/Total Debt	19.7	18.7	16.8		
Reserves/Total Debt	138.0	112.2	106.7		
Debt Service Ratio	4.8	4.6	5.5		

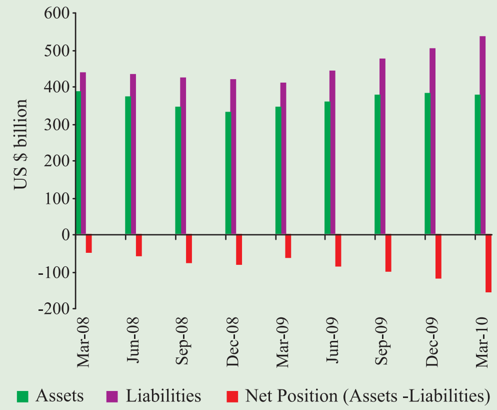
P: Provisional. PR: Partially Revised.

International Investment Position

III.18 India's net international liabilities increased by US$ 34.5 billion during the fourth quarter of 2009-10 mainly due to increase in net inflows under portfolio and foreign direct investment to India. Total external financial assets decreased marginally by US$ 1.8 billion to US$ 378.8 billion as at end-March 2010 over the previous quarter due to decline in reserve assets. The reserve assets declined by US$ 4.4 billion due to the valuation loss of US$ 6.6 billion, owing to the appreciation of the US dollar against major international currencies during the quarter. Total international financial liabilities increased by US$ 32.8 billion over the previous quarter to US$ 536.5 billion as at end-March 2010 mainly on account of increase in inflows under both portfolio investment and foreign direct investment (Chart III.7).

III.19 Overall, the external sector developments during 2009-10 suggest higher absorption of foreign capital through a higher current account deficit, a factor that contributed to the recovery. Trends in capital inflows during 2010-11 so far suggest some moderation, while import growth has remained ahead of export growth, reflecting stronger growth in India relative to the global recovery. The near-term external sector outlook could be conditioned by the impact of expected higher import growth relative to exports on the current account deficit and its financing through the capital account in an environment of expected moderation in the capital flows to EMEs.

Chart III.7: International Investment Position of India



IV. MONETARY AND LIQUIDITY CONDITIONS

Reflecting the calibrated monetary exit, the magnitude of the surplus liquidity in the system moderated gradually. In June 2010, however, there was a severe tightness in liquidity caused by the increase in Government's surplus balances with the Reserve Bank due to sharply higher mobilisation under 3G and BWA spectrum auctions. The liquidity situation was effectively managed by the Reserve Bank, which helped avoid spillover to overall term structure of the interest rate. During the first quarter of 2010-11, credit growth to the private sector picked up further reflecting strong recovery as also payments towards 3G and BWA spectrum. Broad money growth, however, was lower due to slowdown in the growth of deposits.

IV.1 The Reserve Bank has been normalising the monetary policy instruments, *i.e.*, the policy rates and the cash reserve ratio (CRR), since the fourth quarter of 2009-10, through a process of calibrated exit from the accommodative monetary policy stance that it had adopted in response to the global crisis. The CRR hikes effected since February 2010 helped in reducing the excess liquidity in the system. The comfortable liquidity situation turned into a deficit fairly rapidly by end-May 2010 due to an increase in currency with the public and build-up of government cash balances.

IV.2 Non-food credit growth of scheduled commercial banks (SCBs) showed acceleration and by the first quarter of 2010-11 crossed the indicative growth trajectory of 20.0 per cent for the year, as set out in the Monetary Policy Statement for 2010-11. Besides strong economic activity, credit raised by telecom companies to pay for the 3G and broadband wireless access (BWA) spectrum contributed to the high rate of credit growth observed during the quarter. Money supply (M_3) growth, however, was below the indicative trajectory of 17.0 per cent, set out in April 2010. The deceleration was largely on account of the slowdown in the growth rate of aggregate deposits with banks (Table IV.1).

Table IV.1: Monetary Indicators

(Amount in Rupees crore)

Item	Outstanding as on July 2, 2010	Variation (year-on-year)			
		2009-10		2010-11	
		Amount	Per cent	Amount	Per cent
1	2	3	4	5	6
I. Reserve Money*	11,73,831	-6,963	-0.7	2,28,880	24.2
(Reserve Money adjusted for CRR changes)			(15.9)		(18.5)
II. Broad Money (M_3)	57,82,141	8,56,523	20.6	7,69,448	15.3
III. Aggregate Deposits of SCBs	46,32,703	7,26,938	22.0	6,01,737	14.9
IV. Non-food Credit of SCBs	33,47,939	3,83,015	16.3	6,10,046	22.3

*: Data pertain to July 16, 2010.

Note: Data are provisional.

Liquidity Management

IV.3 The liquidity conditions changed significantly during the first quarter of 2010-11. The gradual moderation in the volume of surplus liquidity in the system since February 2010 reflected the calibrated normalisation of the monetary policy by the Reserve Bank. Accordingly, the liquidity adjustment facility (LAF) remained in the absorption mode, though the reverse repo volumes declined gradually (Chart IV.1). From end-May 2010, there was a sudden and sharp tightening of liquidity, which was reflected in the reversal of LAF to injection mode. The liquidity tightness was caused by the large increase in government's cash balances with the Reserve Bank, reflecting proceeds from 3G/BWA spectrum auctions, besides the first instalment of advance tax payments.

IV.4 In terms of specific aspects of the evolution of liquidity conditions, the scale of surplus liquidity in the system increased initially at the commencement of the financial year 2010-11 on account of higher government expenditure. The average daily absorption under the LAF increased to Rs.57,150 crore in April 2010 from Rs.37,640 crore in March 2010. With the recovery of the economy firmly in place, the Reserve Bank moved in a calibrated manner in the direction of normalising its policy instruments. To anchor inflation and to prevent further build up of inflationary pressure, the Reserve Bank increased the repo and reverse repo rates as well as the CRR by 25 basis points each in April 2010 in the Annual Monetary Policy for 2010-11 (Table IV.2). The surplus liquidity in the domestic market gradually declined thereafter. The Reserve Bank auctioned cash management bills in May 2010 (which matured in mid-June 2010) to meet the temporary cash flow mismatches of the government. The liquidity conditions, however, changed to injection mode from May 31, 2010 due to sharp increase in government balances with the Reserve Bank, on account of higher than anticipated mobilisation under 3G/BWA spectrum auctions.

Chart IV.1: LAF Volumes

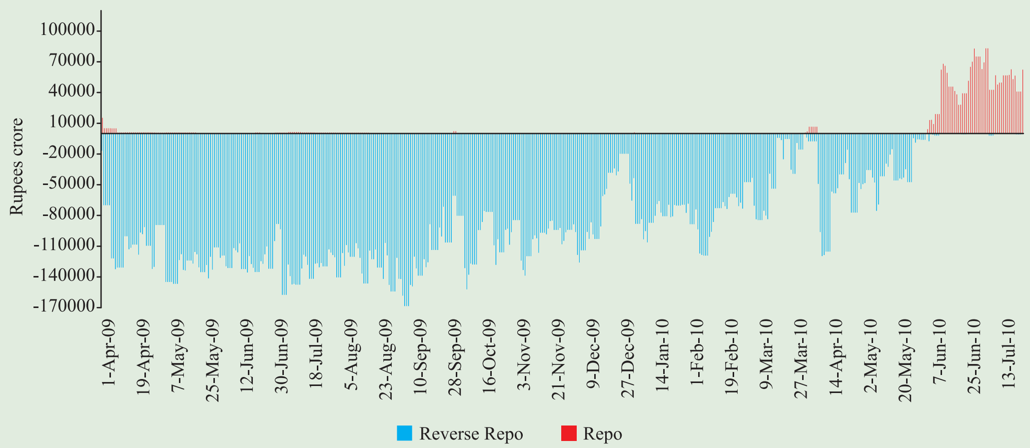


Table IV.2: Movements in Key Policy Rates in India

(Per cent)

Effective since	Reverse Repo Rate	Repo Rate	Cash Reserve Ratio
1	2	3	4
April 26, 2008	6.00	7.75	7.75 (+0.25)
May 10, 2008	6.00	7.75	8.00 (+0.25)
May 24, 2008	6.00	7.75	8.25 (+0.25)
June 12, 2008	6.00	8.00 (+0.25)	8.25
June 25, 2008	6.00	8.50 (+0.50)	8.25
July 5, 2008	6.00	8.50	8.50 (+0.25)
July 19, 2008	6.00	8.50	8.75 (+0.25)
July 30, 2008	6.00	9.00 (+0.50)	8.75
August 30, 2008	6.00	9.00	9.00 (+0.25)
October 11, 2008	6.00	9.00	6.50 (–2.50)
October 20, 2008	6.00	8.00 (–1.00)	6.50
October 25, 2008	6.00	8.00	6.00 (–0.50)
November 3, 2008	6.00	7.50 (–0.50)	6.00
November 8, 2008	6.00	7.50	5.50 (–0.50)
December 8, 2008	5.00 (-1.00)	6.50 (–1.00)	5.50
January 5, 2009	4.00 (-1.00)	5.50 (–1.00)	5.50
January 17, 2009	4.00	5.50	5.00 (–0.50)
March 4, 2009	3.50 (-0.50)	5.00 (-0.50)	5.00
April 21, 2009	3.25 (-0.25)	4.75 (-0.25)	5.00
February 13, 2010	3.25	4.75	5.50 (+0.50)
February 27, 2010	3.25	4.75	5.75 (+0.25)
March 19, 2010	3.50 (+0.25)	5.00(+0.25)	5.75
April 20, 2010	3.75 (+0.25)	5.25 (+0.25)	5.75
April 24, 2010	3.75	5.25	6.00 (+0.25)
July 2, 2010	4.0 (+0.25)	5.50 (+0.25)	6.00

Note: 1. Reverse repo indicates absorption of liquidity and repo indicates injection of liquidity.
2. Figures in parentheses indicate change in policy rates in per cent.

IV.5 In anticipation of temporary tightening of liquidity conditions, the Reserve Bank introduced measures allowing SCBs to avail additional liquidity support under the LAF to the extent of up to 0.5 per cent of their NDTL and also access to second LAF on a daily basis for the period May 28-July 2, 2010. The average daily injection under the LAF during June 2010 was around Rs.47,000 crore in contrast to the average daily absorption of around Rs.33,000 crore in May 2010. Consequently, the call rate moved up significantly, resulting in an effective tightening at the short end of the yield curve. The call rate, however, remained around the ceiling of the LAF corridor set by the repo rate.

IV.6 Overall, increase in currency with the public and centre's surplus balances with the Reserve Bank, both representing withdrawal of liquidity from the system, were the key drivers of autonomous liquidity in Q1 of 2010-11 (Table IV.3). Due to the increase in CRR, there was an additional withdrawal of liquidity, over and above the autonomous impact. The liquidity situation was managed primarily through LAF by injecting liquidity through repo operations (Table IV.4).

IV.7 Excess SLR investments of SCBs amounted to Rs.1,87,705 crore, as on July 2, 2010, compared with Rs.2,85,491 crore a year ago. Adjusted for LAF collateral securities on an outstanding basis, given the repo mode of the LAF, SCBs' maintenance of SLR was 29.6 per cent of NDTL, an excess of 4.6 percentage points over the prescribed SLR (Chart IV.2). The banking system has used a part of the excess SLR securities to access liquidity from the Reserve Bank through repo, and the large availability of excess SLR securities should help in avoiding spillover of tight temporary liquidity conditions to the term structure of the interest rate. Debt buy-back conducted in June 2010 and cancellation of Treasury Bill auctions in June and July 2010, also helped to an extent in alleviating the liquidity pressure.

IV.8 On July 2, 2010, the repo and reverse repo rates were further raised by 25 basis points each to 5.5 per cent and 4.0 per cent, respectively, on account of developments on the inflation front, given that the upside bias to growth projection that was highlighted in the Annual Monetary Policy had materialised. The liquidity management measures,

Table IV.3: Reserve Bank's Liquidity Management Operations

(Rupees crore)

Item	2009-10				2010-11
	Q1	Q2	Q3	Q4	Q1
1	2	3	4	5	6
A. Drivers of Liquidity (1+2+3+4)	**-45,110**	**-44,514**	**-66,785**	**55,055**	**-1,05,206**
1. RBI's net purchase from authorised dealers	-15,874	2,523	436	910	816
2. Currency with the public	-18,690	-9,020	-43,224	-31,650	-58,385
3.a. Centre's surplus balances with RBI	3,382	-67,938	-22,663	85,257	-58,249
3.b. WMA and OD	0	0	0	0	0
4. Others (residual)	-13,928	29,921	-1,334	538	10,612
B. Management of Liquidity (4+5+6+7)	**-21,674**	**62,376**	**89,870**	**1,618**	**67,255**
4. Liquidity impact of LAF	-1,30,020	25,390	86,330	18,795	75,785
5. Liquidity impact of OMO* (net)	43,159	32,869	3,540	2,787	1,550
6. Liquidity impact of MSS	65,187	4,117	0	16,036	2,420
7. First round impact of CRR change	0	0	0	-36,000	-12,500
C. Bank Reserves # (A+B)	**-66,784**	**17,863**	**23,085**	**56,673**	**-37,951**

(+) : Injection of liquidity into the banking system. (-): Absorption of liquidity from the banking system.
* : Includes oil bonds but excludes purchases of government securities on behalf of State Governments.
# : Includes vault cash with banks and adjusted for first round liquidity impact due to CRR change.
Note: Data pertain to March 31 for Q4 and last Friday for all other quarters.

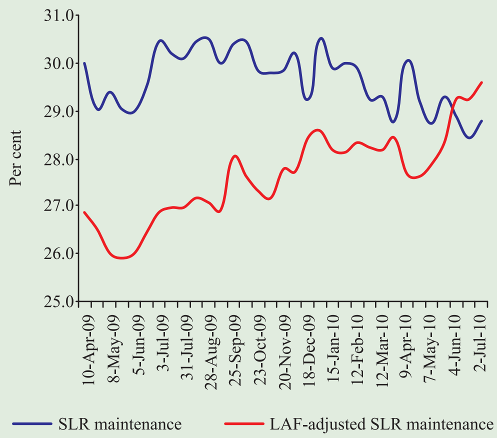
Table IV.4: Liquidity Position

(Rupees crore)

Outstanding as on Last Friday	LAF	MSS	Centre's Surplus@
1	2	3	4
2009			
April	1,08,430	70,216	-40,412
May	1,10,685	39,890	-6,114
June	1,31,505	22,890	12,837
July	1,39,690	21,063	26,440
August	1,53,795	18,773	45,127
September	1,06,115	18,773	80,775
October	84,450	18,773	69,391
November	94,070	18,773	58,460
December	19,785	18,773	1,03,438
2010			
January	88,290	7,737	54,111
February	47,430	7,737	33,834
March*	990	2,737	18,182
April	35,720	2,737	-28,868
May	6,215	317	-7,531
June	-74,795	317	76,431

@ : Excludes minimum cash balances with the Reserve Bank in case of surplus.
* : Data pertain to March 31.
Note: 1. Negative sign in column 2 indicates injection of liquidity through LAF.
2. The second LAF was conducted only on reporting Fridays since May 8, 2009. Since May 28, 2010, the second LAF is being conducted on a daily basis.

Chart IV.2: SLR Maintenance by Banks



introduced earlier on an *ad hoc* basis were also extended up to July 16, 2010. It was clarified that the temporary measures to ease the liquidity pressures were consistent with the overall calibrated monetary exit, which aimed at containing inflation and anchoring inflation expectations without hurting growth. On an assessment of the prevailing overall liquidity conditions and with a view to providing flexibility to SCBs and primary dealers in their liquidity management, the Reserve Bank further extended the second LAF on a daily basis till July 30, 2010. The deficit liquidity conditions have continued in July 2010 so far, and the average daily injection of liquidity during the first three weeks of the month was around Rs.53,000 crore.

Reserve Money

IV.9 In 2009-10, the acceleration in the growth rate of reserve money was primarily on account of increase in bankers' deposits with the Reserve Bank on the components side of reserve money, due to cumulative increase in CRR by 75 basis points during the year. On the sources side, the increase in Reserve Bank's credit to the centre was a major factor, which reflected the liquidity management operations of the Reserve Bank (*i.e.*, MSS unwinding and de-sequestering, open market purchases and LAF operations) to facilitate smooth completion of the large government borrowing programme for 2009-10, while ensuring adequate financing for productive activities and containing inflationary pressures.

IV.10 During the first quarter of 2010-11, the main component of increase in reserve money was currency in circulation (Table IV.5). The higher growth in currency was mainly on account of the increase in demand associated with the strong rebound in economic activities

Table IV.5: Reserve Money - Variations

(Rupees crore)

Item	2009-10				2010-11
	Q1	Q2	Q3	Q4	Q1
1	2	3	4	5	6
Reserve Money	-38,926	16,216	51,816	1,38,583	15,685
Components (1+2+3)					
1. Currency in Circulation	29,692	1,081	45,442	32,181	64,785
2. Bankers' Deposits with RBI	-72,664	20,680	5,456	1,07,552	-49,042
3. Other Deposits with RBI	4,046	-5,545	918	-1,150	-59
Sources (1+2+3+4-5)					
1. RBI's Net Credit to Government	-11,145	-14,953	51,428	1,24,676	15,796
of which to Centre	-11,497	-14,968	51,597	1,24,688	15,807
2. RBI's Credit to Banks and Commercial Sector	-9,623	-3,747	-5,926	-2,384	851
3. Net Foreign Assets of RBI	-16,750	50,120	-15,108	-66,428	14,613
4. Government's Currency Liabilities to the Public	254	302	309	351	238
5. Net Non-Monetary Liabilities of RBI	1,662	15,506	-21,113	-82,369	15,814
Memo:					
LAF - Repo (+) / Reverse Repo (-)	-1,32,800	28,170	67,765	37,360	39,375
Net Open Market Sales *	-42,001	-31,591	-1,894	17	-8
Centre's Surplus	-13,156	77,713	17,519	-80,112	37,405
MSS Balances	-65,187	-4,117	0	-16,036	-2,420

*: Excludes Treasury Bills.

Note: 1. The sum of the memo items will not add up to the net Reserve Bank credit to the Centre as LAF and OMO transactions are at face value and also due to margin adjustment for LAF operations.

2. Data based on March 31 for Q4 and last reporting Friday for all other quarters.

3. Data are provisional.

4. Centre's surplus includes Government's investment balance and cash balance with the Reserve Bank.

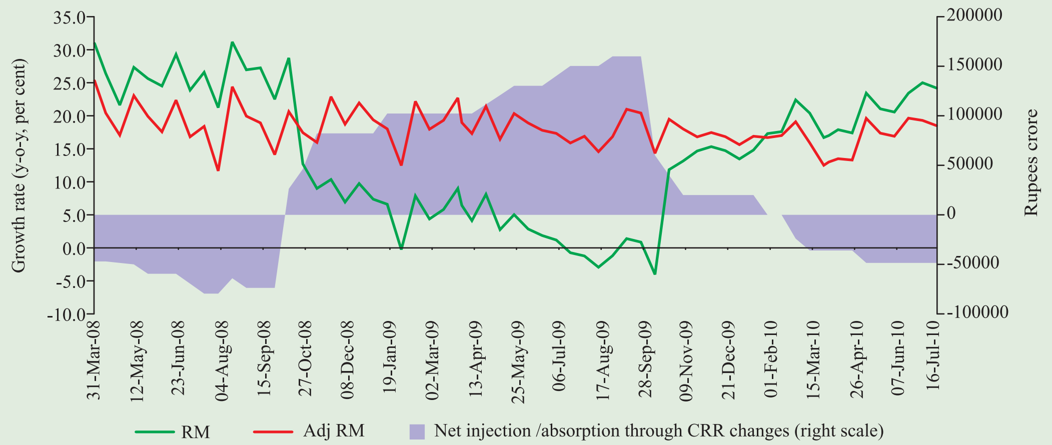
as well as the spurt in inflation. On the sources side, the increase in reserve money was led by increase in Reserve Bank's credit to the centre, primarily reflecting the repo operations in the market[1], and unwinding of balances under the MSS. This was partially offset by the increase in government's cash balances with the Reserve Bank. The net foreign exchange assets of the Reserve Bank also increased during the quarter.

IV.11 Since bankers' deposits with the Reserve Bank, a key determinant of reserve money on the components side, change in response to variations in CRR effected by the Reserve Bank as a part of its monetary policy actions, it is useful to analyse the behaviour of base money adjusted for the CRR changes. The adjusted reserve money increased by 18.5 per cent (y-o-y) as on July 16, 2010, reflecting the impact of increase in currency in circulation (on the components side) and Reserve Bank credit to the government (on the sources side) (Chart IV.3).

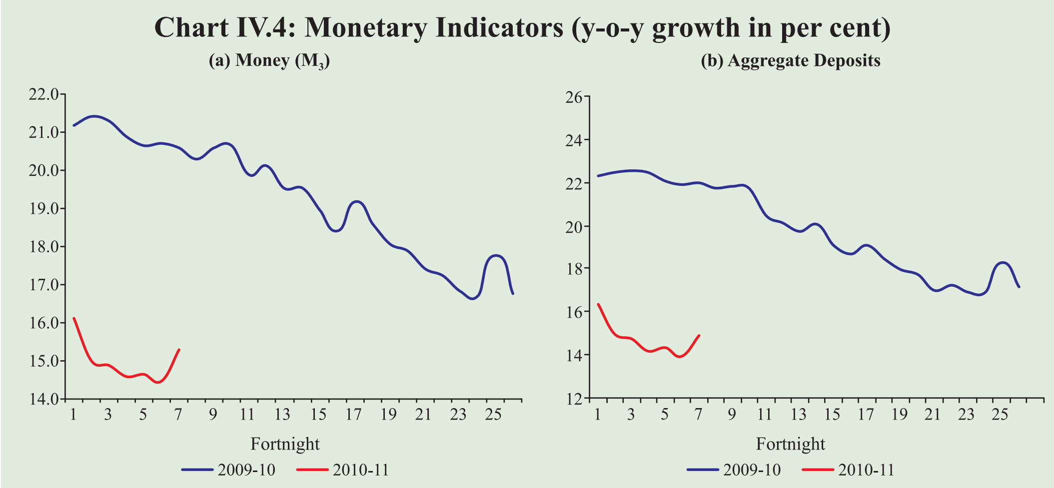
Money Supply

IV.12 The deceleration in the growth of M_3 continued up to mid-June 2010 (Chart IV.4 a). This was on account of the deceleration of its major component, *i.e.*, aggregate deposits (Table IV.6 and Chart IV.4 b). The moderation in the growth of time deposits was particularly sharp, which was partly a response to the low deposit rates, given high inflation. During the fortnight ended July 2, 2010, aggregate deposits registered a fortnightly increase of about Rs.1,15,000 crore; it is likely that the increased off-take of credit has begun to be reflected in deposit growth. There has been an increased inflow into small savings schemes since August 2009 as returns on investments in small savings have been higher than on time

Chart IV.3: Reserve Money and Adjusted Reserve Money



[1] The Reserve Bank's credit to the Centre is affected by LAF operations, OMO, MSS balances and Government's cash surplus with the Reserve Bank. Increase in repo/OMO purchases and decline in reverse repo/MSS balances/Government's surplus balances with Reserve Bank lead to increase in net Reserve Bank credit to the Centre, and *vice versa*.



deposits with banks since the beginning of 2009-10 (Chart IV.5). Total incremental inflows into small savings are, however, a small fraction of monthly increases in time deposits, notwithstanding the deceleration in the growth of time deposits.

IV.13 As regards sources of M_3, the increase in money supply during the quarter came mainly from banking system's credit to the commercial sector. There has been sustained acceleration in growth of non-food credit extended by SCBs since the last

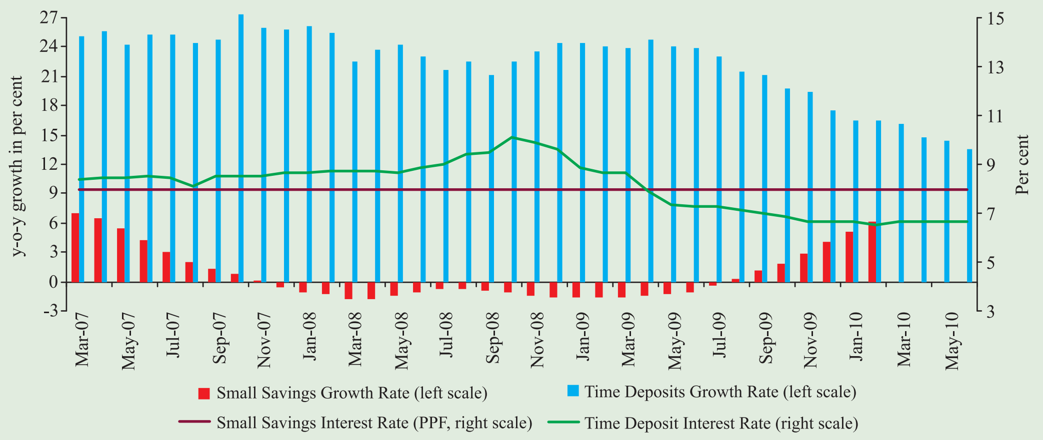
Table IV.6: Monetary Aggregates - Variations

(Rupees crore)

Item	2009-10				2010-11
	Q1	Q2	Q3	Q4	Q1
1	2	3	4	5	6
M_3 (1+2+3 = 4+5+6+7-8)	1,63,787	1,61,970	1,24,777	3,54,416	77,314
Components					
1 Currency with the Public	24,913	2,797	45,086	29,787	64,381
2 Aggregate Deposits with Banks	1,34,829	1,64,717	78,773	3,25,778	12,992
2.1 Demand Deposits with Banks	-40,911	66,320	-26,343	1,34,985	-88,146
2.2 Time Deposits with Banks	1,75,739	98,397	1,05,116	1,90,793	1,01,138
3 'Other' Deposits with RBI	4,046	-5,545	918	-1,150	-59
Sources					
4 Net Bank Credit to Government	1,20,816	71,703	35,598	1,61,646	41,051
4.1 RBI's Net Credit to Government	-11,145	-14,953	51,428	1,24,676	15,796
4.2 Other Banks' Credit to Government	1,31,961	86,656	-15,830	36,970	25,255
5 Bank Credit to the Commercial Sector	-7,232	1,07,136	68,093	3,09,890	65,642
6 Net Foreign Assets of Banking Sector	-37,923	47,908	-20,701	-59,998	14,613
7 Government's Currency Liabilities to the Public	254	302	309	351	238
8 Net Non-Monetary Liabilities of the Banking Sector	-87,872	65,079	-41,478	57,472	44,231

Note: Data are provisional.

Chart IV.5: Time Deposits and Small Savings



quarter of 2009-10 (Chart IV.6 a). Telecom operators raised credit to pay for the 3G/ BWA spectrums, which partly contributed to the stronger growth in credit. With tepid deposit mobilisation (barring the fortnight ending on July 2, 2010), the incremental non-food credit deposit ratio of SCBs moved up to over 100 per cent (Chart IV.6 b). On outstanding basis though, the non-food credit to deposit ratio was 72.3 per cent on July 2, 2010.

IV.14 Given the deceleration in deposits and acceleration in the growth of non-food credit, there has been a deceleration in banks' investment in government securities since November 2009, which is the time when growth in non-food credit turned around (Chart IV.7).

IV.15 The revival in credit demand was reflected in the lending figures for all bank groups, with foreign banks and private sector banks in particular, showing significant

Chart IV.6: Credit Indicators

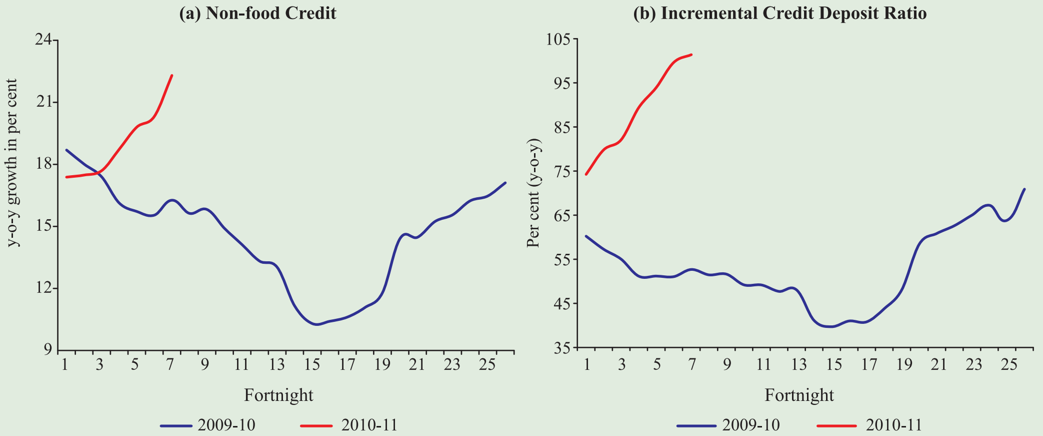
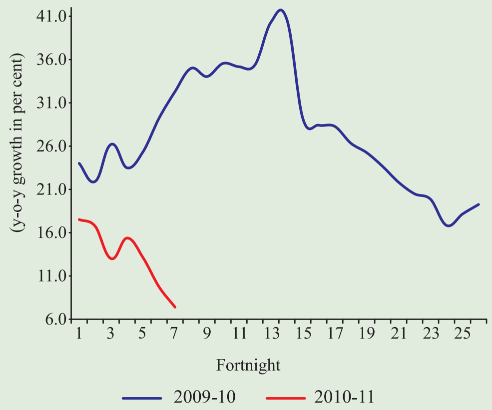


Chart IV.7: Investment in Government Securities



improvement in their y-o-y credit growth compared to last year (Table IV.7). Credit growth from the public sector banks continued to be the highest and also most stable.

IV.16 Disaggregated data on sectoral deployment of gross bank credit show improvement in credit growth (y-o-y) to industry, though the flow is yet not broad-based (Table IV.8). Industry absorbed 57.9 per cent of incremental non-food credit (y-o-y) in May 2010 as compared with 47.4 per cent in the corresponding month of the previous year. This expansion was led by infrastructure, textiles, food processing, paper and paper products, petroleum, coal products and nuclear fuels, chemicals and chemical products, and vehicles, vehicle parts and transport equipments. The share of incremental non-food credit to micro and small enterprises (industry as well as services), however, declined to 11.9 per cent in May 2010 as compared with 16.0 per cent in May 2009. Within services sector, credit to real estate decelerated sharply, reflecting definitional change to the concept of "lending to real estate sector" effected in September 2009.

IV.17 Banking system accounted for roughly 65 per cent of the total flow of financing to the commercial sector during the first quarter of 2010-11, even as the flow from non-bank sources also increased significantly over the corresponding period of the previous year. Besides bank credit, issuance of IPOs, credit from housing finance companies, external commercial

Table IV.7: Credit Flow from Scheduled Commercial Banks

(Amount in Rupees crore)

Item	Outstanding as on July 2, 2010	Variation (Y-on-Y)			
		As on July 3, 2009		As on July 2, 2010	
		Amount	Per cent	Amount	Per cent
1	2	3	4	5	6
1. Public Sector Banks	25,26,007	3,71,522	22.0	4,62,443	22.4
2. Foreign Banks	1,79,111	-12,257	-7.2	20,307	12.8
3. Private Banks	6,17,033	18,716	3.8	1,10,019	21.7
4. All Scheduled Commercial Banks*	34,02,390	3,89,967	16.2	6,06,823	21.7

*: including Regional Rural Banks.
Note: Data are provisional.

Table IV.8: Deployment of Gross Bank Credit by Major Sectors

(Amount in Rupees crore)

Sector	Outstanding as on May 21, 2010	Variation (year-on-year) May 22, 2009 Amount	Per cent	May 21, 2010 Amount	Per cent
1	2	3	4	5	6
Non-Food Gross Bank Credit (1 to 4)	**30,21,481**	**3,83,512**	**17.6**	**4,63,235**	**18.1**
1. Agriculture and Allied Activities	**3,99,494**	**65,345**	**24.7**	**69,362**	**21.0**
2. Industry	**13,08,721**	**1,81,932**	**21.2**	**2,68,274**	**25.8**
3. Personal Loans	**5,89,003**	**24,489**	**4.6**	**36,032**	**6.5**
Housing	3,05,325	15,095	5.7	26,870	9.6
Advances against Fixed Deposits	47,032	3,718	8.8	1,093	2.4
Credit Card Outstanding	19,579	382	1.4	-7,398	-27.4
Education	36,961	7,342	34.4	8,267	28.8
Consumer Durables	8,138	- 1,651	-17.1	140	1.8
4. Services	**7,24,263**	**1,11,746**	**21.4**	**89,568**	**14.1**
Transport Operators	52,170	8,721	24.7	8,202	18.7
Professional Services	49,549	9,537	29.9	8,070	19.5
Trade	1,60,985	19,852	16.2	18,695	13.1
Real Estate Loans	95,659	33,499	54.9	1,115	1.2
Non-Banking Financial Companies	1,11,037	22,529	31.3	16,534	17.5
Memo					
Priority Sector	**10,65,619**	**1,46,173**	**19.1**	**1,52,429**	**16.7**
Small Enterprises	3,72,867	61,551	24.0	55,129	17.4
Industry	**13,08,721**	**1,81,932**	**21.2**	**2,68,274**	**25.8**
Food Processing	67,938	2,903	5.7	14,543	27.2
Textiles	1,20,643	7,790	8.3	18,937	18.6
Paper and Paper Products	19,536	1,936	14.0	3,774	23.9
Petroleum, Coal Products and Nuclear Fuels	63,080	3,552	7.5	12,240	24.1
Chemicals and Chemical Products	79,864	5,250	8.0	9,216	13.0
Rubber, Plastic and their Products	16,570	2,284	20.6	3,169	23.7
Iron and Steel	1,29,169	23,522	29.8	26,814	26.2
Other Metal and Metal Products	35,470	5,406	21.5	4,951	16.2
Engineering	73,821	12,709	24.2	8,561	13.1
Vehicles, Vehicle Parts and Transport Equipments	37,544	2,958	9.9	4,570	13.9
Gems and Jewellery	31,651	3,016	12.1	3,809	13.7
Construction	43,876	11,671	44.7	6,123	16.2
Infrastructure	3,96,544	71,384	35.1	1,21,829	44.3

Note: 1. Data are provisional and relate to select banks.
2. The deceleration in credit to real estate reflects largely the definitional change to the concept of lending to real estate sector effected in September 2009.

borrowings and ADRs/GDRs were the other important sources of finance for the commercial sector (Table IV.9).

IV.18 Reflecting the strong growth momentum and sharp acceleration in investment demand, credit to the private

Table IV.9: Flow of Financial Resources to the Commercial Sector

(Rupees crore)

Item	April-March		April-June	
	2008-09	2009-10	2009-10	2010-11
1	2	3	4	5
A. Adjusted Non-food Bank Credit	**4,21,091**	**4,80,258**	**2,529**	**1,62,373**
i) Non-food Credit	4,11,824	4,66,960	8,555	1,51,640$
of which petroleum and fertiliser credit	31,159	8,491	-18,796	-8,274#
ii) Non-SLR Investment by SCBs	9,267	13,298	-6,026	10,733$
B. Flow from Non-banks (B1+B2)	**4,61,702**	**5,97,263**	**58,946**	**87,837**
B1. Domestic Sources	**2,79,908**	**3,81,431**	**38,659**	**54,091**
1. Public issues by non-financial entities	14,205	31,956	236	5,187
2. Gross private placements by non-financial entities	77,856	1,41,964	N.A.	N.A.
3. Net issuance of CPs subscribed to by non-banks	4,936	25,835	27,134	29,178 *
4. Net credit by housing finance companies	25,876	24,226	-892	4,028 #
5. Total gross accommodation by the four RBI regulated AIFIs - NABARD, NHB, SIDBI & EXIM Bank	31,408	33,871	-4,339	-3,097 #
6. Systemically important non-deposit taking NBFCs (net of bank credit)	42,277	60,663	8,004	14,859 #
7. LIC's gross investment in corporate debt, infrastructure and social sector	83,350	62,916	8,517	3,936 #
B2. Foreign Sources	**1,81,794**	**2,15,832**	**20,287**	**33,746**
1. External Commercial Borrowings / FCCBs	31,350	14,356	-1,805	9,091
2. ADR/GDR Issues excluding banks and financial institutions	4,788	15,124	215	4,832
3. Short-term credit from abroad	-12,972	35,170	N.A.	N.A.
4. FDI to India	1,58,628	1,51,182	21,877	19,823 #
C. Total Flow of Resources (A+B)	**8,82,793**	**10,77,521**	**61,475**	**2,50,210**
Memo Item:				
Net resource mobilisation by Mutual Funds through Debt (non-Gilt) Schemes	**-32,168**	**96,578**	**80,149**	**8,335**

$: Up to July 2, 2010. #: April-May, 2010. *: Up to June 15, 2010.
N. A.: Not Available.

sector recovered significantly. Flow of resources from non-banks also increased to meet the financing needs of the private sector. Broad money growth remained below the trajectory envisaged by the Monetary Policy Statement for 2010-11, largely due to the deceleration in the growth of aggregate deposits up to mid-June 2010. There has been a turnaround in the growth of both broad money and deposits, which though coincided with a period of pick-up in credit to telecom companies and the switchover to the base rate. The tightness in liquidity conditions would ease, but the calibrated normalisation of monetary policy may not lead to return of the persistent easy liquidity conditions that prevailed last year. Banks, therefore, have to step-up mobilisation of deposits to meet the demand for credit from both the private sector and the government.

V. FINANCIAL MARKETS

Risks to the global financial system increased in Q2 of 2010 in the wake of market concerns about fiscal sustainability in the Euro area and possible spillover to other parts of the world. Domestic financial markets functioned normally during Q1 of 2010-11 though there was some spillover from global volatility. While call money rates edged up due to tight liquidity conditions created by higher revenue inflows to the government, medium to long-term bond yields moderated because of expectations of lower fiscal deficit. Exchange rate of the Indian rupee exhibited some depreciation and equity prices remained mostly subdued, reflecting the impact of the global market trends and FII flows. Housing prices exhibited moderate growth in Q4 of 2009-10.

V.1 The global financial markets witnessed greater volatility, drop in risk appetite and flight to safety during Q2 of 2010, reflecting rising fiscal sustainability concerns, weaker outlook for recovery than anticipated earlier and waning investor confidence. Domestic markets, particularly equity, exhibited spillover of global market volatility, notwithstanding the firmer domestic recovery in growth. Domestic fiscal concerns, which had impacted the government bond market in 2009-10 and kept pressure on the medium to long-term yield, remained contained in Q1 of 2010-11 because of the expectation of lower fiscal deficit resulting from larger realisations through 3G/BWA spectrum auctions. Sudden tightening of liquidity in the system in June 2010 exerted pressure on short-term interest rates, though the medium to long-term bond yields declined on receding domestic fiscal risks.

International Financial Markets

V.2 Although global financial market conditions had improved during 2009 in terms of reduced risk spreads and higher market activity, risks resurfaced towards the end of 2009 and intensified during the first half of 2010. A series of events, starting from debt default of Dubai World, the Greek sovereign debt crisis, spreading of contagion to Spain and other euro area countries and weakening of market confidence reflecting unresolved deep-rooted problems in the financial systems, contributed to the significant volatility in the global financial markets.

V.3 During Q2 of 2010, global financial markets turned highly volatile as fiscal problems of the euro area and other advanced economies and the risk of anaemic global growth, together led to significant deterioration in investor confidence. Deteriorating fiscal position across euro area continued to cause jitters in financial markets, despite transient stability instilled by the announcement of a significant European rescue package. These developments forced investors to scale down their risk exposures.

V.4 The perception that unsustainable public debt of the advanced economies would weigh heavily on the global growth outlook, continues to unsettle equity markets. The signs of growing stress and the fragility of the global financial system were evident in the rising Libor-OIS spreads (Chart V.1a). Specific events, such as growing geopolitical risk in the Korean peninsula, the second sovereign downgrade of Spain by the rating agencies, and difficulties faced by the Spanish savings banks, also weakened the market confidence.

V.5 Investors, cautious about the rising and potential risks in the global financial system, reduced their exposure to risky assets. Consequently, there was flight to safe haven assets. This led to a significant fall in sovereign bond yields (Chart V.1b and c). At the same time, investors' risk perception towards countries inflicted with fiscal problems remained high (Chart V.1d). In both the advanced and emerging market economies (EMEs) stock prices fell significantly and remained volatile (Chart V.1e). Corporate credit spreads, which had remained broadly stable after the Dubai World default, again widened (Charts V.1f and g). The fiscal problems and uncertainty about the growth outlook for the euro area also led to high volatility in currency markets with sharp depreciation of the Euro against other major currencies, though with some recovery in July 2010 (Chart V.1h). While the Euro depreciated against the US dollar, the EME currencies like Russian ruble, Turkish lira, Indian rupee, South Korean won, Argentine peso and Mexican peso came under depreciation pressure due to volatile capital flows and the general safe haven flight to the US dollar (Table V.1).

V.6 Increased volatility in international markets was rapidly transmitted to India and other EMEs through volatile capital flows during Q2 of 2010. Reflecting the impact of global market uncertainty, capital inflows to India moderated, led by portfolio flows. This, in turn, led to depreciation of the rupee and moderation in stock prices.

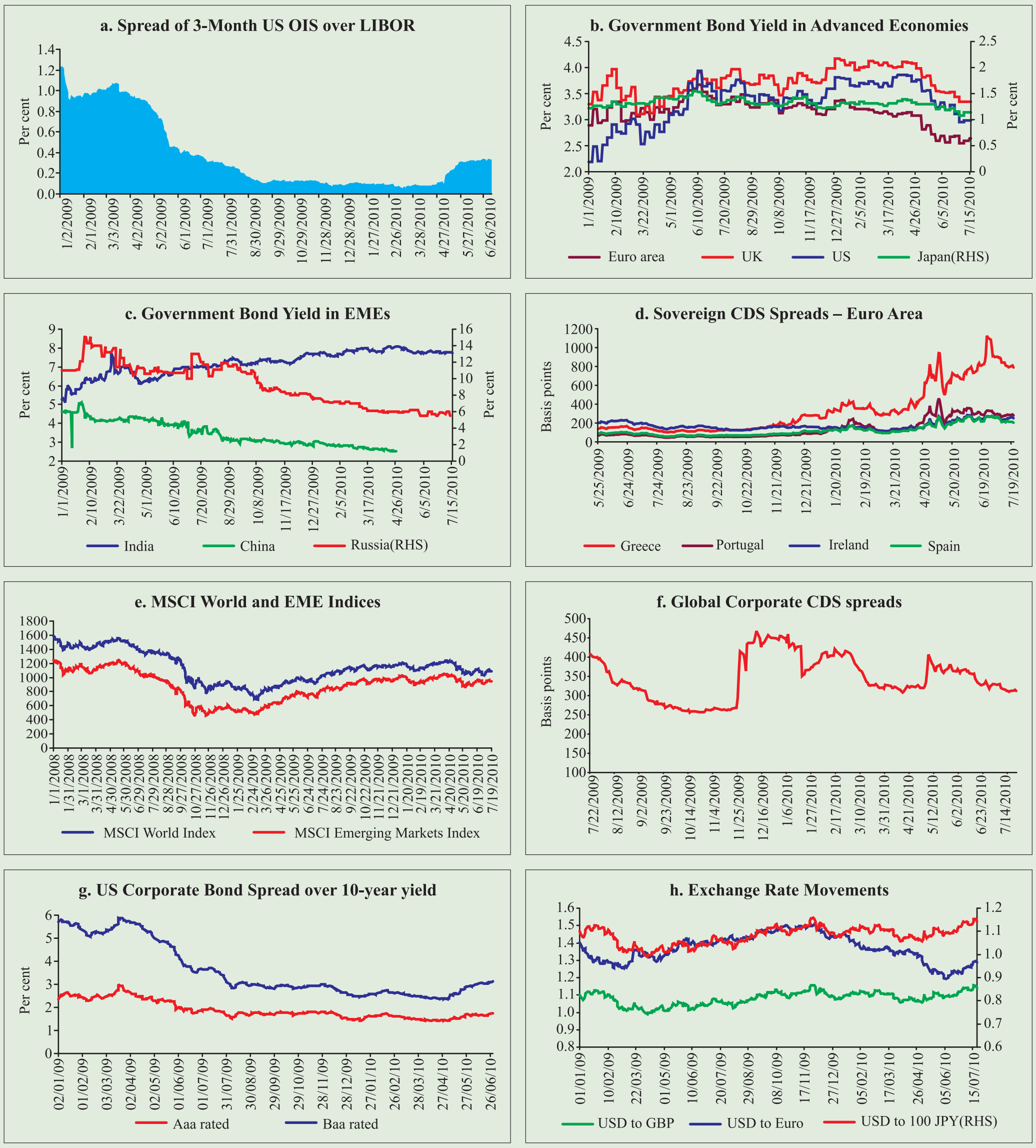
Domestic Financial Markets

V.7 The concerns in domestic financial markets shifted from the large fiscal deficit and rising inflation in 2009-10 to escalated uncertainties in the global markets and the associated risks to global recovery in Q1 of 2010-11. Nevertheless, several segments of financial markets witnessed further recovery in trading volumes in Q1 of 2010-11, although marked by some increase in price volatility (Table V.2 and Chart V.2). Except for some increase in spread/volatility in certain segments, overall financial market conditions remained stable.

Money Market

V.8 Liquidity conditions in the inter-bank market tightened significantly in June 2010, reflecting temporary withdrawal of liquidity from the banking system due to sharp increase in the Government's one-off collections through 3G/BWA spectrum auction (about Rs.1,31,000 crore) besides the first installment of advance tax payments. Thus, call rate that had mostly remained around the lower bound of the informal LAF corridor up to May 2010, increased subsequently and hovered around the upper bound of the informal LAF corridor (Chart V.3). Responding to this liquidity tightening, the Reserve Bank's

Chart V.1: Indicators of Global Financial Market Developments



Source: The IMF, the Federal Reserve of St. Louis, the Bloomberg and the Datastream.

LAF window turned from reverse repo to repo mode. In order to address the liquidity pressures, additional liquidity support was provided to scheduled commercial banks under the LAF to the extent of 0.5 per cent of their net demand and time liabilities (NDTL). The Reserve Bank also conducted second LAF on a daily basis. These measures helped overcome liquidity stress in money markets and contain volatility in call rates.

V.9 Transaction volumes in the collateralised borrowing and lending

Table V.1: Currency and Stock Price Movement in EMEs

(Per cent)

Items	End-March 2009 @	End-March 2010 @	July 19, 2010*	Items	End-March 2009 @	End-March 2010 @	July 16, 2010*
1	2	3	4	1	2	3	4
Appreciation (+)/Depreciation (-) of the US Dollar				**Stock Price Variations**			
Japanese Yen	-2.0	-4.9	-6.5	Indonesia (Jakarta Composite)	-41.4	93.7	7.7
Chinese Yuan	-2.6	-0.1	-0.8	Brazil (Bovespa)	-32.9	71.9	-11.4
Russian Ruble	44.3	-13.0	3.3	Thailand (SET Composite)	-47.2	82.6	5.0
Turkish Lira	27.7	-9.1	1.1	India (BSE Sensex)	-37.9	80.5	2.4
Indian Rupee	27.5	-11.4	3.7	South Korea (KOSPI)	-29.2	40.3	2.7
Indonesian Rupiah	25.6	-21.3	-0.7	China (Shanghai Composite)	-31.7	31.0	-22.0
Malaysian Ringgit	14.4	-10.3	-2.0	Taiwan (Taiwan Index)	-39.2	52.0	-3.2
South Korea Won	38.9	-17.8	6.5	Russia (RTS)	-66.4	128.0	-11.6
Thai Baht	12.8	-8.9	-0.1	Malaysia (KLSE)	-30.1	51.3	1.2
Argentine Peso	17.3	4.4	1.5	Singapore (Straits Times)	-43.5	69.9	2.4
Brazilian Real	31.2	-19.8	-1.5				
Mexican Peso	32.9	-12.3	3.9				

@: Year-on-year variation. * Variation over End-March.
Source: Bloomberg, IFS, IMF.

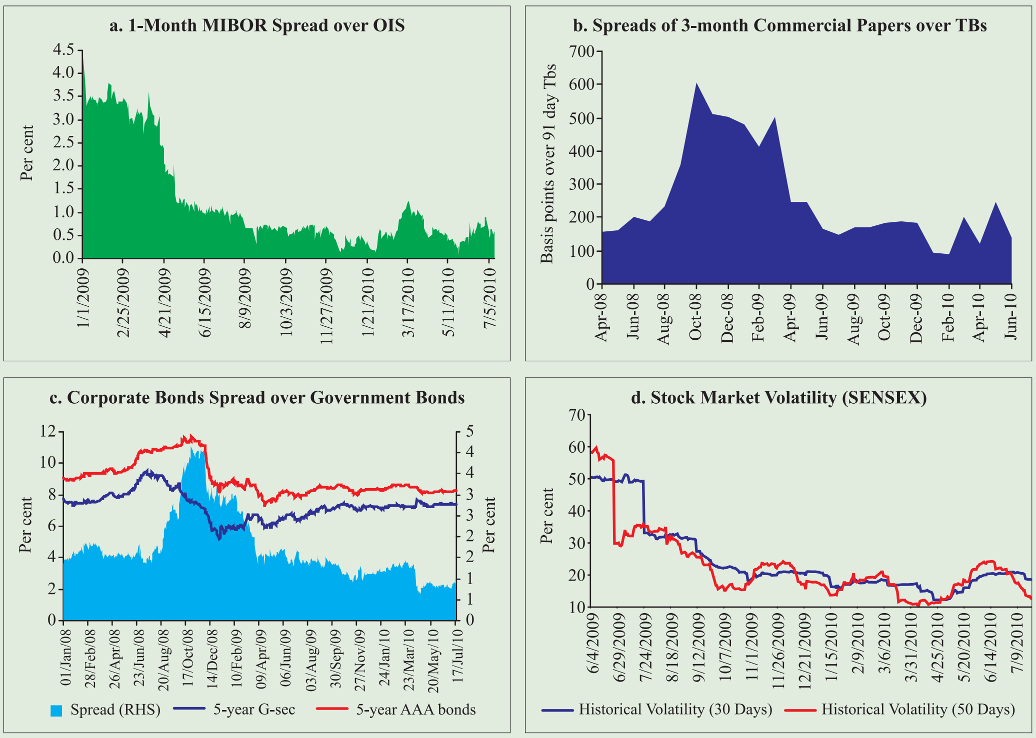
obligation (CBLO) and market repo segments continued to remain high during Q1 of 2010-11 (Table V.3). As in the previous year, banks were the major borrowers in the collateralised segment and mutual funds (MFs) were the major

Table V.2: Domestic Financial Markets at a Glance

Year/Month	Call Money		Govt. Securities Market		Foreign Exchange Market			Liquidity Management		Stock Markets			
	Daily Turnover (Rs. crore)	Call Rates* (Per cent)	Daily Turnover^ (Rs. Crore)	10-Year Yield@ (Per cent)	Daily Inter-bank Turnover (US$ mn)	Exchange rate@ (Rs./ US$)	RBI's net FC purchase (+)/ sale (-)	MSS Out-standing# (Rs. crore)	Average Daily LAF (Rs. crore)	Daily BSE Turnover (Rs. crore)	Daily NSE Turnover (Rs. crore)	BSE Sensex**	CNX Nifty**
1	2	3	4	5	6	7	8	9	10	11	12	13	14
2008-09	**22,436**	**7.06**	**10,879**	**7.54**	**34,812**	**45.92**	**-34,922†**	**1,48,889**	**2,885**	**4,498**	**11,325**	**12303**	**3713**
2009-10	**15,924**	**3.24**	**14,426**	**7.23**	**30,107**	**44.95**	**-2,635†**	**23,914**	**1,00,015**	**5,651**	**16,959**	**15585**	**4658**
Apr-09	21,820	3.28	15,997	6.55	27,796	50.06	-2,487	75,146	1,01,561	5,232	15,688	10911	3360
May-09	19,037	3.17	14,585	6.41	32,227	48.53	-1,437	45,955	1,25,728	6,427	19,128	13046	3958
Jun-09	17,921	3.21	14,575	6.83	32,431	47.77	1,044	27,140	1,23,400	7,236	21,928	14782	4436
Jul-09	14,394	3.21	17,739	7.01	30,638	48.48	-55	22,159	1,30,891	6,043	18,528	14635	4343
Aug-09	15,137	3.22	9,699	7.18	27,306	48.34	181	19,804	1,28,275	5,825	17,379	14415	4571
Sep-09	16,118	3.31	16,988	7.25	27,824	48.44	80	18,773	1,21,083	6,211	18,253	16338	4859
Oct-09	15,776	3.17	12,567	7.33	28,402	46.72	75	18,773	1,01,675	5,700	18,148	16826	4994
Nov-09	13,516	3.19	17,281	7.33	27,599	46.57	-36	18,773	1,01,719	5,257	16,224	16684	4954
Dec-09	13,302	3.24	14,110	7.57	27,439	46.63	0	18,773	68,522	4,671	13,948	17090	5100
Jan-10	12,822	3.23	12,614	7.62	32,833	45.96	0	9,944	81,027	6,162	17,813	17260	5156
Feb-10	13,618	3.17	12,535	7.79	34,040	46.33	0	7,737	78,661	4,125	12,257	16184	4840
Mar-10	17,624	3.51	8,544	7.94	32,755	45.50	0	3,987	37,640	4,751	13,631	17303	5178
Apr-10	16,374	3.49	14,242	8.01	36,242 P	44.50	0	2,737	57,150	4,696	13,828	19679	5295
May-10	16,786	3.83	24,225	7.56	39,997 P	45.81	0	922	32,798	3,940	12,937	16845	5053
Jun-10	14,258	5.16	21,300	7.59	36,216 P	46.57	..	317	-47,347	4,204	13,005	17300	5188

* : Average of daily weighted call money borrowing rates. ^: Average of daily outright turnover in Central Government dated securities.
@ : Average of closing rates. #: Average of weekly outstanding MSS. **: Average of daily closing indices. †: Cumulative for the financial year.
LAF : Liquidity Adjustment Facility. MSS: Market Stabilisation Scheme. BSE: Bombay Stock Exchange Limited.
NSE : National Stock Exchange of India Limited. P: Provisional. .. : Not available.
Note: In column 10, (-) indicates injection of liquidity, while (+) indicates absorption of liquidity.

Chart V.2: Spread and Volatility in Domestic Financial Markets



lenders. The collateralised segment of the money market accounted for around 87 per cent of the total volume during Q1 of 2010-11.

V.10 The average certificates of deposit (CD) issuance was placed around Rs.20,600 crore during this financial year (till July 2, 2010) so far, as compared with the average

Chart V.3: Money Market Interest Rates

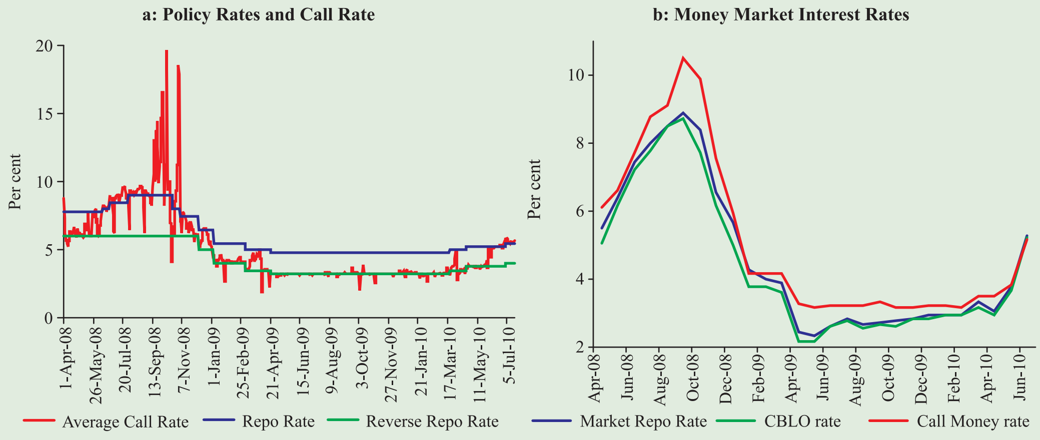


Table V.3: Activity in Money Market Segments

(Rupees crore)

Year/Month	Average Daily Volume (One Leg)						Commercial Paper		Certificates of Deposit	
	Call	Market Repo	CBLO	Total (2 to 4)	Money Market Rate (%)*	Term Money	Outstanding	WADR (%)	Outstanding	WADR (%)
1	2	3	4	5	6	7	8	9	10	11
Apr-09	10,910	20,545	43,958	75,413	2.41	332	52,881	6.29	2,10,954	6.48
May-09	9,518	22,449	48,505	80,472	2.34	338	60,740	5.75	2,18,437	6.20
Jun-09	8,960	21,694	53,553	84,207	2.69	335	68,721	5.00	2,21,491	4.90
Jul-09	7,197	20,254	46,501	73,952	2.83	389	79,582	4.71	2,40,395	4.96
Aug-09	7,569	23,305	57,099	87,973	2.62	461	83,026	5.05	2,32,522	4.91
Sep-09	8,059	27,978	62,388	98,425	2.73	381	79,228	5.04	2,16,691	5.30
Oct-09	7,888	23,444	58,313	89,645	2.70	225	98,835	5.06	2,27,227	4.70
Nov-09	6,758	22,529	54,875	84,162	2.87	191	1,03,915	5.17	2,45,101	4.86
Dec-09	6,651	20,500	55,338	82,489	2.91	289	90,305	5.40	2,48,440	4.92
Jan-10	6,411	14,565	50,571	71,547	2.97	404	91,564	4.80	2,82,284	5.65
Feb-10	6,809	19,821	63,645	90,275	2.95	151	97,000	4.99	3,09,390	6.15
Mar-10	8,812	19,150	60,006	87,968	3.22	393	75,506	6.29	3,41,054	6.07
Apr-10	8,187	20,319	50,891	79,397	3.03	423	98,769	5.37	3,36,807	5.56
May-10	8,393	17,610	42,274	68,277	3.72	330	1,09,039	6.85	3,40,343	5.17
Jun10	7,129	9,481	31,113	47,723	5.22	447	99,792	6.82	3,21,589	6.37

CBLO: Collateralised Borrowing and Lending Obligation. WADR: Weighted Average Discount Rate.
* : Weighted average rate of call, market repo and CBLO.

issuance of around Rs.16,700 crore during 2009-10. The volume in commercial paper (CP) market picked up, as corporates increasingly took recourse to CPs for financing their working capital requirements, which is evident from a significant rise in the share of 'manufacturing companies' in the outstanding amount of CPs (Table V.4). The tightening of liquidity in money markets led to some upward pressure on interest rates.

Government Securities Market

V.11 The Reserve Bank continued with the policy of front-loading of market borrowings during the first half of 2010-11. Accordingly, the Government would complete a major part (about 63 per cent) of the gross market borrowing programme for 2010-11 in the first half of the year so as to limit any crowding-out concerns in the latter

Table V.4: Major Issuers of Commercial Paper

(Rupees crore)

End of Period	Leasing and Finance		Manufacturing		Financial Institutions		Total Outstanding
	Amount	Share (%)	Amount	Share(%)	Amount	Share(%)	
1	2	3	4	5	6	7	8=(2+4+6)
Mar-09	27,183	61.5	12,738	28.8	4,250	9.6	44,171
Jun-09	34,437	50.1	23,454	34.1	10,830	15.8	68,721
Sep-09	31,648	39.9	31,509	39.7	16,071	20.3	79,228
Dec-09	36,027	39.9	42,443	47.0	11,835	13.1	90,305
Mar-10	39,477	52.3	22,344	29.4	13,685	18.1	75,506
Jun-10	42,572	42.7	43,330	43.4	13,890	13.9	99,792

Table V.5: Issuances of Central and State Government Dated Securities

	2008-09	2009-10	2009-10$	2010-11$
1	2	3	4	5
Central Government				
Gross amount raised (Rs. crore)	2,61,000	4,18,000	1,62,000	1,51,000
Devolvement on Primary Dealers (Rs. crore)	10,773	7,219	1,873	1,834
Bid-cover ratio (Range)	1.2-4.5	1.4-4.3	1.52-3.51	1.39-3.87
Weighted average maturity (years)	13.8	11.2	11.9	10.3
Weighted average yield (per cent)	7.69	7.23	6.93	7.62
State Governments				
Gross amount raised (Rs. crore)	1,18,138	1,31,122	20,266	23,322
Cut-off yield (per cent)	5.80-9.90	7.04-8.58	7.04-7.89	8.05-8.58
Weighted average yield (per cent)	7.87	8.11	7.52	8.31

$: Up to June 30.

half of the year when the private credit demand is normally strong (Table V.5). Due to outflow of liquidity from the banking system on account of 3G/BWA auctions and rise in policy rates, there was an upward movement in the primary market yields of Treasury Bills except for 364-day T-bills which showed a slight moderation initially (Table V.6). The tightening liquidity conditions were partially addressed by scaling down the issuance of Treasury Bills in June 2010 from the planned Rs. 37,000 crore to Rs. 15,000 crore. Further, the second quarter auction calendar for T-Bills has planned for a reduction in net issuance by Rs.24,000 crore. The Government also bought back dated securities to the tune of Rs. 9,614 crore up to July 20, 2010. The notified amount of dated securities for July 2, 2010 auction was lowered from the planned amount of Rs.13,000 crore to Rs.10,000 crore. Cash management bills of 28 and 35 days maturity were also issued in May 2010.

Table V.6: Treasury Bills in the Primary Market

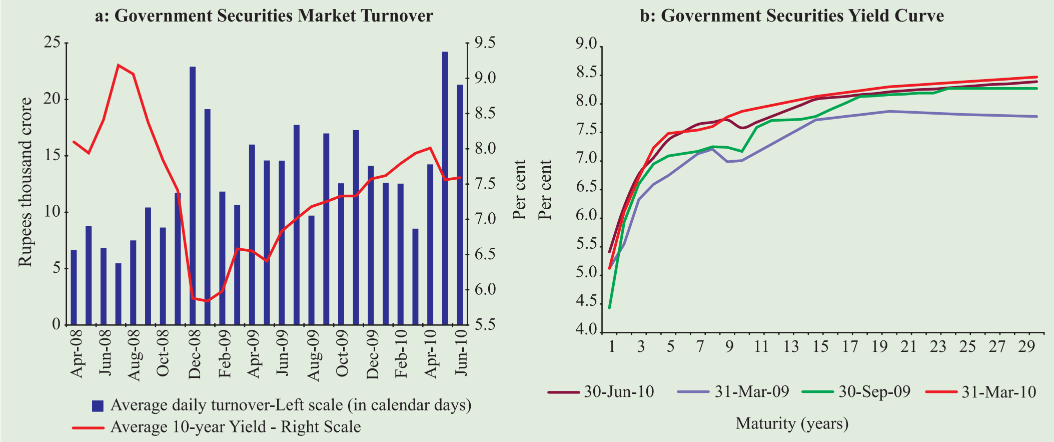
Year/ Month	Notified Amount (Rupees crore)	Average Implicit Yield at Minimum Cut-off Price (Per cent)		
		91-day	182-day	364-day
1	2	3	4	5
2008-09	**2,99,000**	**7.10**	**7.22**	**7.15**
2009-10	**3,80,000**	**3.57**	**4.00**	**4.37**
2010-11	**87,000**	**4.66**	**4.90**	**5.21**
Apr-10	36,000	4.14	4.64	5.07
May-10	36,000	4.39	4.76	4.92
Jun-10	15,000	5.29	5.31	5.49

V.12 During Q1 of 2010-11, though short-term yields remained low till end-May due to surplus liquidity conditions, they hardened thereafter, reflecting the tightness in liquidity arising out of 3G/BWA auctions as well as quarterly advance tax payments. The yield at the longer end eased, presumably on expectations of improved fiscal position of the government because of higher than anticipated 3G/BWA auction revenues (Chart V.4). As fiscal deficit concerns for 2010-11 receded, the volume in government securities market improved in Q1 of 2010-11.

Credit Market

V.13 The spreads on corporate bonds over the government bond yield declined in Q1 of 2010-11 over the levels in Q4 of 2009-10, indicating further reduction in risk

Chart V.4: Turnover and Yield in Government Securities Market



for corporates due to improved growth outlook (Chart V.2c).

V.14 Bank deposit rates have started moving upward, reflecting not only the competition for attracting deposits but also a change in the interest rate environment reflected in gradually rising policy rates (Table V.7). During Q1 of 2010-11, a few banks raised their deposits rates in the range of 75-100 basis points. On the lending side,

Table V.7: Deposit and Lending Rates of Banks

(Per cent)

	Mar 09	Sep 09	Dec 09	Mar 10	Jun 10
1	2	3	4	5	6
1. Domestic Deposit Rate					
Public Sector Banks					
Up to 1 year	2.75-8.50	1.00-7.00	1.00-6.25	1.00-6.50	1.00-6.25
> 1year-3 years	8.25-9.25	6.50-8.00	6.00-7.25	6.00-7.25	6.00-7.25
> 3 years	8.00-9.00	7.00-8.50	6.25-7.75	6.50-7.75	6.50-7.75
Private Sector Banks					
Up to 1 year	2.50-9.25	2.00-7.50	2.00-6.75	2.00-6.50	2.00-6.50
> 1year-3 years	7.25-9.25	6.00-8.75	5.25-7.50	5.25-7.75	6.25-7.50
> 3 years	7.25-9.75	6.00-9.00	5.75-8.00	5.75-8.00	6.50-8.00
Foreign Banks					
Up to 1 year	2.25-9.25	1.80-8.00	1.25-7.00	1.25-7.00	1.25-7.00
> 1year-3 years	3.50-9.75	2.25-8.50	2.25-7.75	2.25-8.00	3.00-8.00
> 3 years	3.60-9.50	2.25-9.50	2.25-8.50	2.25-8.75	3.00-8.50
2. BPLR					
1. Public Sector Banks	12.25-13.50	11.00-13.50	11.00-13.50	11.00-13.50	11.00-13.50
2. Private Sector Banks	13.00-16.50	12.50-16.75	12.50-16.75	12.50-16.75	12.50-16.75
3. Foreign Banks	10.00-15.50	10.50-16.00	10.50-16.00	10.50-16.00	10.50-16.00
3. Actual Lending Rate*					
1. Public Sector Banks	4.00-17.75	3.50-17.50	3.25-18.00	3.25-18.00	
2. Private Sector Banks	4.00-24.00	4.10-26.00	3.50-25.84	3.00-28.00	
3. Foreign Banks	5.00-28.00	2.76-25.50	3.50-22.00	3.60-23.00	

* : Interest rate on non-export demand and term loans above Rs. 2 lakh excluding lending rates at the extreme five per cent on both sides.

the benchmark prime lending rates (BPLRs) of SCBs have remained unchanged since July 2009. The switch over to the base rate system from July 1, 2010 is expected to bring about greater transparency in lending rates. The base rates announced by major public sector banks so far are in the narrow range of 7.25 per cent to 8.0 per cent.

Foreign Exchange Market

V.15 The Indian rupee exhibited greater two-way movement against the US dollar during Q1 of 2009-10. The rupee strengthened against the US dollar in April 2010 on the back of capital inflows and positive growth outlook. Subsequently, with the signs of the euro area debt crisis spreading further and the US dollar strengthening against most currencies, and withdrawal of funds by the FIIs, the rupee came under depreciation pressure (Chart V.5a). The exchange rates in the non-deliverable forward market (NDF), the currency future market and the spot market have exhibited similar pattern (Chart V.5b).

V.16 Increased volatility in the foreign exchange market resulted alongside increase in turnover in the spot, forward and futures markets (Chart V.6a and b). The rupee-dollar futures continued to dominate the currency futures segments in the exchanges, accounting for about 90 per cent of the total notional values. The higher trading volumes, particularly in the futures market, have coincided with the increased volatility in the spot exchange rate.

Equity and Housing Markets

V.17 The sustained growth in equity prices that was witnessed in 2009-10, exhibited some correction in Q1 of 2010-11, mainly due to transmission of shocks from global markets (Table V.8), though there has been some recovery in July 2010.

V.18 The activity in the primary segment of the domestic capital market displayed signs of revival in Q1 of 2010-11. Resources raised through public issues increased considerably (Table V.9). The resource mobilisation by

Chart V.5: Nominal Exchange Rate

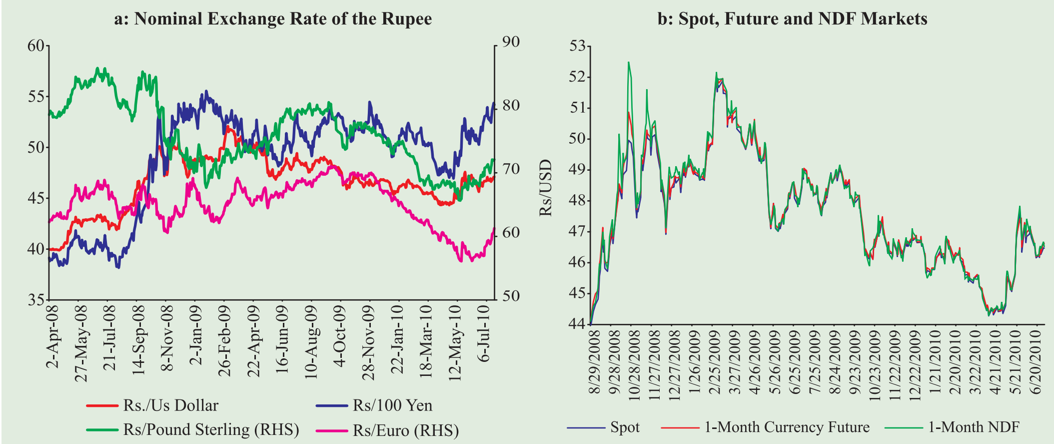
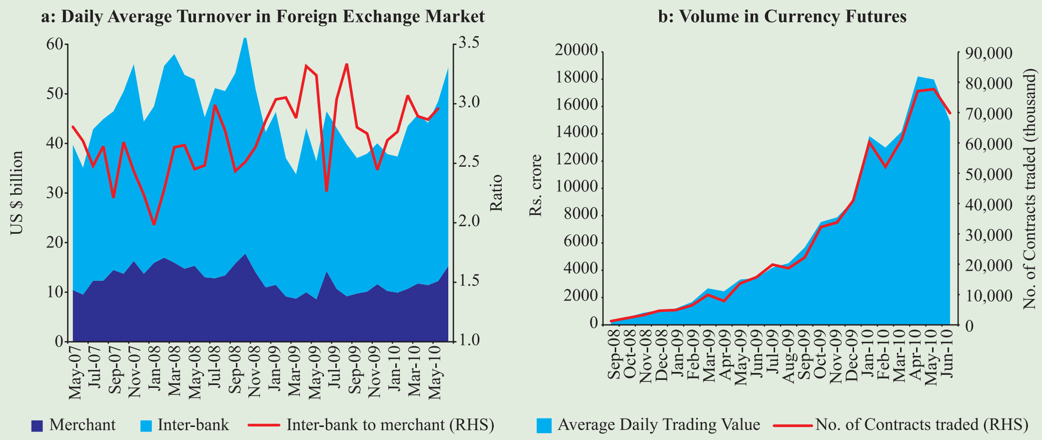


Chart V.6: Turnover in Foreign Exchange Market



mutual funds was, however, lower due to tight liquidity conditions and subdued stock markets. During 2009-10, mobilisation of resources by corporates through private placement (Rs.3,42,445 crore) was higher by 67.8 per cent.

V.19 Stock prices remained subdued during most part of Q1 of 2010-11 due to concerns regarding adverse global developments (Chart V.7a). While FII investments remained volatile, mutual funds turned net sellers due to increased market uncertainties. With increasing uncertainties and corrections in domestic stock prices, derivatives segment exhibited significant expansion in volumes (Chart V.7b).

V.20 A sustained and rapid rise in housing prices over successive quarters remains an area of concern from the standpoint of their possible spillover to demand pressures and the general price

Table V.8: Key Stock Market Indicators

Indicator	BSE				NSE			
	2008-09	2009-10	2009-10 (Apr- Jun)	2010-11 (Apr- Jun)	2008-09	2009-10	2009-10 (Apr-Jun)	2010-11 (Apr-Jun)
1	2	3	4	5	6	7	8	9
1. BSE Sensex/S&PCNX Nifty								
(i) End-period	9709	17528	14494	16945	3021	5249	4291	5313
(ii) Average	12366	15585	13078	17268	3731	4658	3964	5177
2. Coefficient of Variation	24.2	11.9	13.1	2.8	23.2	11.3	12.3	2.7
3. Price-Earning Ratio (end-period)*	13.7	21.3	19.0	21.1	14.3	22.3	20.0	22.3
4. Price-Book Value Ratio	2.7	3.9	3.5	3.4	2.5	3.7	3.6	3.8
5. Market Capitalisation to GDP Ratio (per cent)	59.0	106.5	92.2	82.0	55.4	103.8	89.8	76.5

*: Based on 30 scrips included in the BSE Sensex and 50 scrips included in the S&P CNX Nifty. @: As at end-period.
Source: Bombay Stock Exchange Ltd. (BSE) and National Stock Exchange of India Ltd. (NSE).

Table V.9: Resource Mobilisation from Capital Market

(Rupees crore)

Category	2008-09 (Apr-Mar)	2009-10 (Apr-Mar)	2009-10 (Apr-Jun)	2010-11 (Apr- Jun)
1	2	3	4	5
A. Prospectus and Rights Issues*	14,671	32,607	236	7,737
1. Private Sector (a+b)	14,671	25,479	236	7,737
a) Financial	466	326	–	2,550
b) Non-financial	14,205	25,153	236	5,187
2. Public Sector	–	7,128	–	–
B. Euro Issues	4,788	15,967	215	4,844
C. Mutual Fund Mobilisation (net)@	-28,296	83,080	1,00,403	3,547
1. Private Sector	-34,017	54,928	81,456	14,109
2. Public Sector #	5,721	28,152	18,947	-10,562

*: Excluding offer for sale @: Net of redemptions. #: Including UTI Mutual fund.

Note: Data exclude funds mobilised under Fund of Funds Schemes.

Source: Mutual Fund data are sourced from Securities and Exchange Board of India.

level as well as financial stability (Table V.10 and Chart V.8). During Q4 of 2009-10, however, housing prices displayed subdued momentum in several cities, which could be attributed to concerns of high valuations and the volatile stock market.

V.21 Despite increasing global market uncertainties emanating from the euro area fiscal sustainability concerns, domestic markets functioned normally, though with higher volatility in some segments. Domestic equity prices moderated, though with some recovery in the recent period. The exchange rate showed greater two-way movement partly reflecting rising pressure on the euro and volatility in FII flows. Domestic money markets faced liquidity pressures, leading to hardening of short-term money market rates.

Chart V.7: Movement in Sotck Prices and Turnover

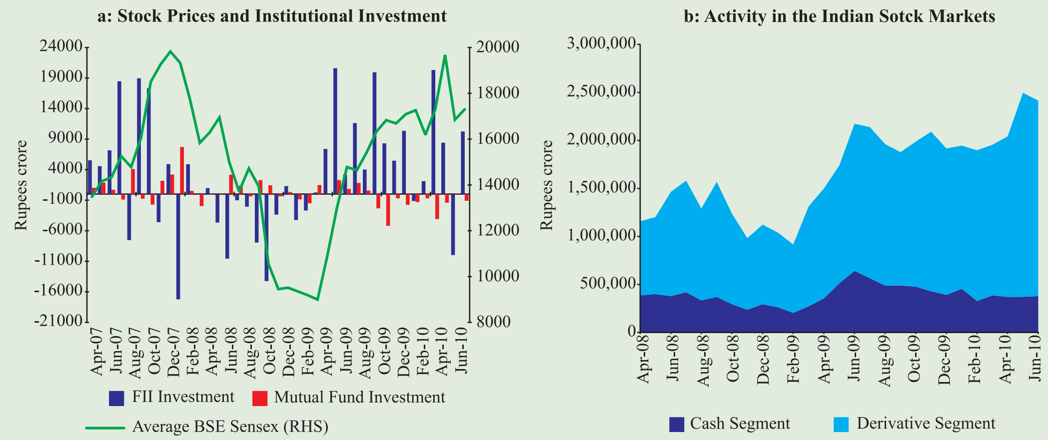


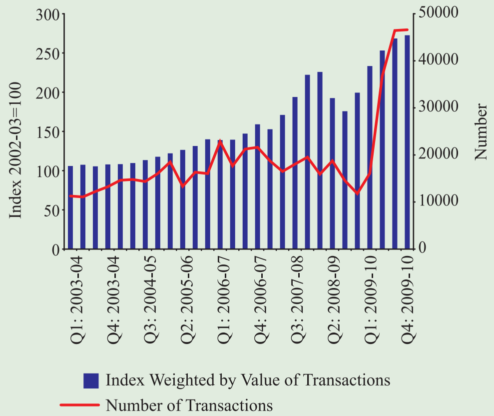
Table V.10: House Price Index (Base=Q4: 2008-09)*

(Per cent)

Quarter	Bangalore		Ahmedabad		Delhi#		Mumbai#	
	Index	Price Change (Q-on-Q)	Index	Price Change (Q-on-Q)	Index	Price Change (Q-on-Q)	Index	Price Change (Q-on-Q)
1	2	3	4	5	6	7	8	9
Q4: 2008-09	100.0	–	100.0	–	100.0	–	100.0	–
Q1: 2009-10	103.6	3.6	101.4	1.4	101.9	1.9	116.0	16.0
Q2: 2009-10	101.7	-1.9	104.2	2.7	103.2	1.3	131.0	12.9
Q3: 2009-10	100.8	-0.9	117.3	12.6	107.4	4.1	135.1	3.1
Q4: 2009-10	98.5	-2.3	124.3	5.9	136.4	27.0	136.4	1.0

* : Based on weights obtained from number of transactions
\# : Delhi and Mumbai indices are shifted to common base.
Source: Department of Registration and Stamps of the respective State Governments.

Chart V.8: Movement in Residential House Prices in Mumbai



Responding to these developments, the Reserve Bank initiated temporary liquidity facilities that helped contain inter-bank call rates around the ceiling of the LAF corridor. Medium to long-term yields, however, moderated on expectations of lower fiscal deficit of the Government and the general safe haven appeal of government bonds globally. The market activities in various segments improved and the primary segment of the domestic capital market exhibited larger mobilisation of resources.

VI. PRICE SITUATION

The headline inflation has remained in double digits since February 2010, with increasing generalisation of price pressures over successive months. Food prices, the initial source of inflationary pressure, though moderated somewhat, still remain high. What has been particularly significant for the conduct of monetary policy is the manner in which non-food manufactured inflation accelerated from near zero in November 2009 to 7.3 per cent by June 2010. Given the risks that high and persistent inflation could pose to the growth momentum as well as to the progress on inclusive growth, timely initiation of monetary policy measures to anchor inflation expectations and contain the inflation persistence has become essential. This is reflected in the Reserve Bank's calibrated normalisation of monetary policy, since October 2009.

VI.1 In the second half of 2009-10, the year-on-year WPI inflation increased significantly and reached 11.0 per cent by March 2010. What started as a supply side pressure on inflation led by high food prices in response to the deficient monsoon, became increasingly more generalised. In the first quarter of 2010-11, the headline inflation remained elevated in double digits, despite some moderation in prices of food products. Manufactured non-food products inflation further accelerated, indicating the strengthening of demand side pressures on inflation. Changes in administered prices as well as upward revisions in price indices that reflected lagged reporting of past price increases, contributed significantly to the increase in WPI in recent months. The decision of the Government to increase the prices of administered petroleum products and allow full pass-through of global crude price increases in the case of petrol in June 2010 is estimated to directly contribute about 0.9 percentage point increase to the WPI inflation immediately, apart from the indirect impact with a lag. Moderation in international commodity prices in recent months, following the downside risks to global growth from the euro area fiscal concerns, could ease some pressure on inflation. With a stronger recovery and consequent increasing demand side pressures, containing inflation expectations will remain as the highest priority for monetary policy during 2010-11.

Global Inflation

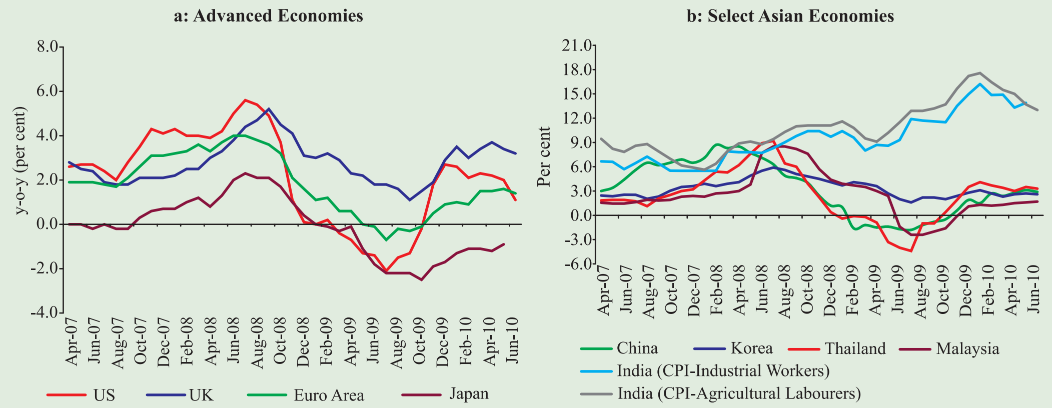
VI.2 The global inflation environment exhibited divergent trends, with the advanced economies still facing the risk of a possible deflation on the one hand and the EMEs starting to face the build-up of inflationary pressures on the other. Core inflation in advanced economies continues to remain subdued, indicating existence of large spare capacity. Despite well anchored inflation expectations, advanced economies have witnessed gradual increase in headline inflation since October/November 2009 from very low or negative levels during the first half of 2009. This was mainly on account of the waning of base effect of sharp decline in commodity prices that was recorded during the second half of 2008 (Chart VI.1 a).

VI.3 Year-on-year consumer price inflation in OECD countries, which was negative during the period June-September 2009, increased to 2.0 per cent in May 2010. Core inflation (excluding food and energy) remained stable at around 1.5 per cent since June 2009, and declined to 1.3 per cent in May 2010 indicating absence of any pressure on inflation from the demand side. Core inflation in the euro area had declined in recent months, following the fiscal turbulence. A weaker euro, however, is expected to negate the possibility of a deflationary situation, even when private consumption demand remains relatively weak.

VI.4 Emerging economies, on the other hand, face risks to inflation from both supply and demand sides. On the supply side, the significant increases in international commodity prices from their historic low levels recorded in early 2009 exerted pressures on inflation, notwithstanding the recent moderation in international commodity prices. The pressure from commodity price increase on inflation is more in the case of developing countries as their consumption baskets have larger shares of commodities, especially food and oil, unlike the advanced economies. As emerging economies exhibited stronger recovery and faster closing of output gap, risks to inflation from the demand side have also started to emerge. Moreover, stronger growth in emerging economies could also lead to further increases in demand for commodities, specially oil and metals, which in turn, could lead to additional increases in their prices internationally. Inflation in most of the emerging market economies increased in recent months (Chart VI.1b).

VI.5 Concerns over recession and the subsequent fragile recovery were the major factors guiding the monetary policy stance adopted by most of the central banks in the advanced economies during 2009-10. Policy rates, accordingly, were left unchanged at near zero levels. During the second half of 2009-10, some inflationary pressures started to emerge, particularly in

Chart VI.1: Consumer Price Inflation



Source: International Financial Statistics and official websites of respective countries.

economies which witnessed faster than expected recovery and gradual closing of the output gap. This led to exit from crisis time easy monetary policy in those countries. The Reserve Bank of Australia and Bank of Israel have increased their policy rates by 150 and 100 basis points, respectively since September 2009. Greater uncertainty about the recovery, particularly since the escalation of fiscal concerns in the euro area, made most central banks in advanced economies to delay the increase in policy rates, except Bank of Canada which has raised the policy rate by 50 basis points since June 2010 (Table VI.1). Among the emerging economies, Brazil, Korea and Thailand have raised their policy rates since April 2010, and China has raised the reserve requirement ratio by a total of 150 basis points since January 2010. China has also taken measures to ease the overheating of asset prices.

Table VI.1: Global Inflation Indicators

(Per cent)

Country/ Region	Key Policy Rate	Policy Rate	(as on July 23, 2010)	Changes in Policy Rates (basis points)		CPI Inflation (y-o-y)	
				Apr-09 - Aug-09	Since Sep-09	June 2009	June 2010
1	2	3		4	5	6	7
Developed Economies							
Australia	Cash Rate	4.50	(May 05, 2010)	(-) 25	150	2.5 ^	2.9^
Canada	Overnight Rate	0.75	(Jul. 20, 2010)	(-) 25	50	0.1*	1.4*
Euro area	Interest Rate on Main Refinancing Operations	1.00	(May 13, 2009)	(-) 50	0	-0.1	1.4
Japan	Uncollateralised Overnight Call Rate	0.10	(Dec.19, 2008)	0	0	-1.1*	-0.9*
UK	Official Bank Rate	0.50	(Mar. 05, 2009)	0	0	1.8	3.2
US	Federal Funds Rate	0.00 to 0.25	(Dec.16, 2008)	0	0	-1.4	1.1
Developing Economies							
Brazil	Selic Rate	10.25	(Jul. 22, 2010)	(-) 250	200	4.8	4.8
India	Reverse Repo Rate	4.00	(Jul. 02, 2010)	(-) 25	75	8.6*	13.9*
	Repo Rate	5.50	(Jul. 02, 2010)	(-) 25	75 (100)		
China	Benchmark 1-year Lending Rate	5.31	(Dec 23, 2008)	0	0 (150)	-1.7	2.9
Indonesia	BI Rate	6.50	(Aug. 05, 2009)	(-) 125	0	3.7	5.0
Israel	Key Rate	1.50	(Apr. 01, 2010)	(-) 25	100	3.6	2.4
Korea	Base Rate	2.25	(Jul. 09, 2010)	0	25	2.0	2.6
Philippines	Reverse Repo Rate	4.00	(Jul. 09, 2009)	(-) 75	0	1.5	3.9
Russia	Refinancing Rate	7.75	(Jun. 01, 2010)	(-) 225	(-) 300	11.9	5.8
South Africa	Repo Rate	6.50	(Mar. 26, 2010)	(-) 250	(-) 50	8.0*	4.6*
Thailand	1-day Repurchase Rate	1.50	(Jul. 14, 2010)	(-) 25	25	-4.0	3.2

^ : Q1. *: May.

Note : 1. For India, data on inflation pertain to CPI for Industrial Workers.

2. Figures in parentheses in column (3) indicate the dates when the policy rates were last revised.

3. Figures in parentheses in column (5) indicate the variation in the cash reserve ratio during the period.

Source: International Monetary Fund, websites of respective central banks.

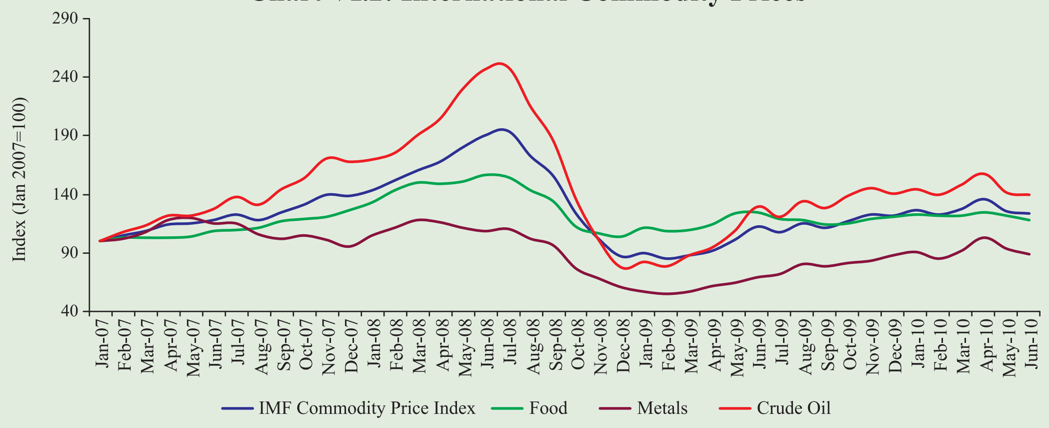
Global Commodity Prices

VI.6 International commodity prices started increasing in early 2009 and rebounded ahead of the global recovery, driven largely by the stronger growth impulses in EMEs and expected increase in demand, going forward (Chart VI.2). Since April 2010, however, some decline in commodity prices has been observed, as concerns over euro area recovery and sustainability of high growth in demand in emerging economies spilled over to commodity markets.

VI.7 Crude oil prices had increased by about 70 per cent (year-on-year) in 2009-10. International crude prices have been volatile in recent months of 2010-11 tracking the uncertainties in global recovery. Crude oil prices declined about 11 per cent during April-June 2010. According to the World Bank, world crude oil demand is projected to record a growth of 1.9 per cent during 2010, with most of the incremental demand coming from the developing economies. Ample surplus capacity may, however, dampen any sustained pressures on oil prices. The IMF's baseline projection for oil prices in 2010 has been revised downwards to US$ 75.3 per barrel in July 2010 from US$ 80 per barrel in April 2010.

VI.8 Metal prices, which increased significantly during 2009 on account of strong demand, especially from China, moderated in recent months. International food prices, which were increasing gradually in 2009, led by few crops like sugar and coffee, declined in recent months. The FAO Food Price Index, a measure of the monthly change in international prices of a food basket comprising cereals, oilseeds, dairy, meat and sugar, increased significantly up to January 2010, and has declined since then by about 6.6 per cent up to June 2010. Major agricultural markets are expected to have sufficient supply during 2010, which could keep prices moderate over the medium-term.

Chart VI.2: International Commodity Prices



Source: IMF.

Inflation Conditions in India

Wholesale Price Inflation

VI.9 WPI year-on-year inflation, which remained moderate during April-May 2009 and subsequently turned negative during June-August 2009, increased at a fast pace to reach 11.0 per cent by March 2010 and remains elevated since then (10.6 per cent in June 2010) (Chart VI.3 a and b). The WPI has exhibited sustained increase since February 2009, indicating secular pressure on prices (Chart VI.3 c). This is also corroborated by positive month over month seasonally adjusted annualised inflation (Chart VI.3 d).

VI.10 The WPI inflation continues to remain high at double digits since February 2010, though there have been shifts in the contributors and the relative strength of each item in the WPI basket to inflation. The contribution of food inflation to overall inflation declined from above 100 per cent in December 2009 to about 28 per cent in June 2010. The contributions of the fuel group and the non-food manufacturing group increased with more or less equal weighted contribution of each, suggesting increasing generalisation of the inflationary pressures (Chart VI.4).

VI.11 The current inflationary pressures initially originated from the supply side on account of the shortfall in agricultural production and gradually increasing international commodity prices. With increasing generalisation, the food items as a key driver of inflation has now been replaced by fuel and metals. Commodities

Chart VI.3: Trends in Wholesale Price Inflation

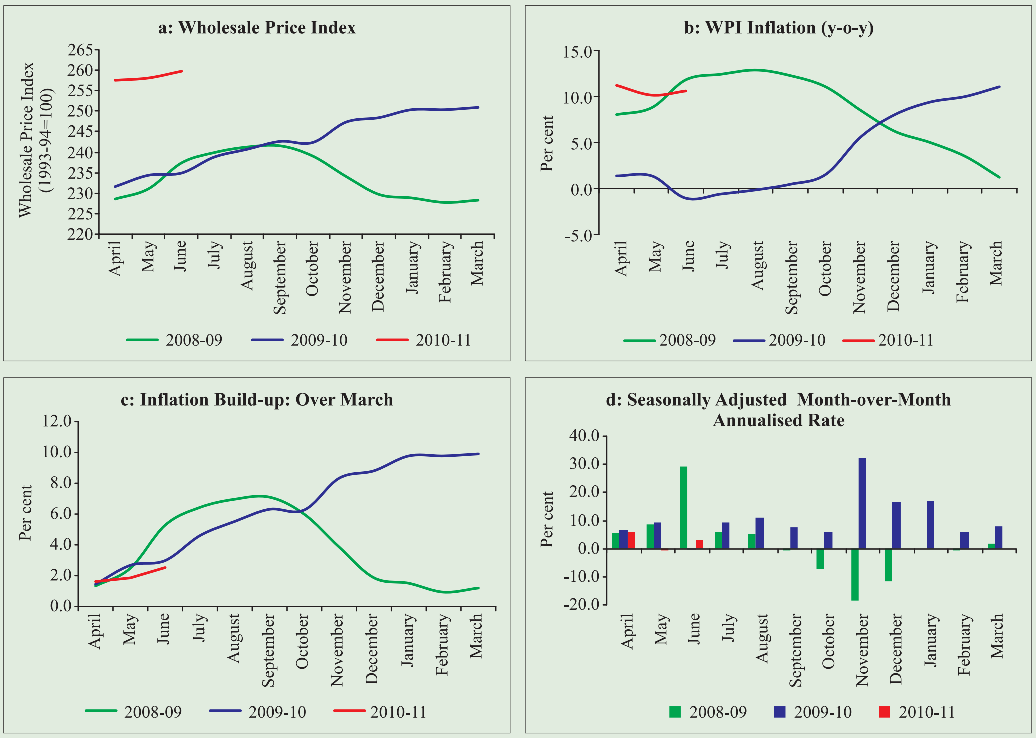
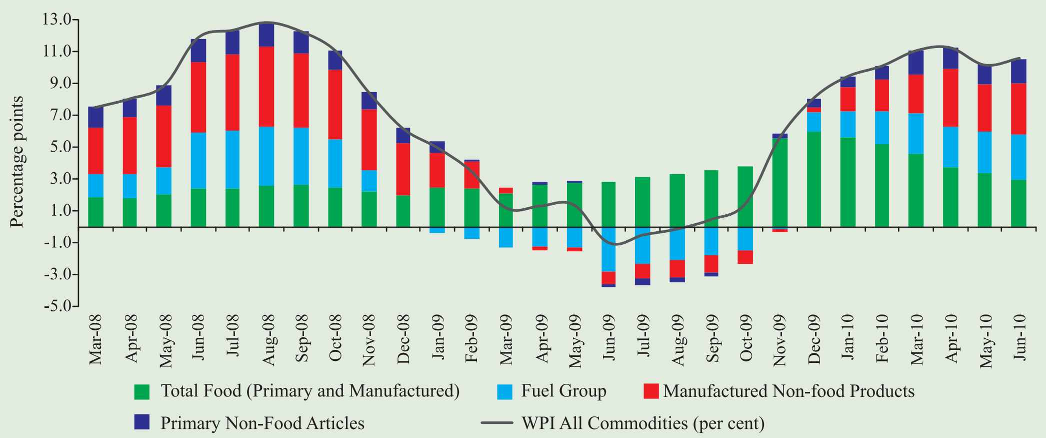


Chart VI.4: Contribution to Overall WPI Inflation - Major Groups (y-o-y)



like milk, egg, fish and meat continue to have high inflation (Chart VI.5)

VI.12 Divergence in inflation across different sub-groups within the commodity groups posed significant challenges in assessing the underlying inflationary pressures during 2009-10. Supply shock dominated divergence should normally remain temporary. Inflation across different sub-groups, after witnessing considerable divergence, have exhibited some convergence in recent months. The decline in food inflation (specially in manufactured food products, led by sugar) along with increase in non-food inflation have led to closing of the gaps between inflation across different commodity groups (Chart VI.6).

VI.13 Inflation in essential commodities group, which increased sharply during the major part of 2009-10, has moderated since January 2010 (Chart VI.7a).The y-o-y WPI inflation, excluding food and fuel, though increased significantly in recent months, continues to remain below the headline inflation. The trend of non-food non-fuel inflation, a rough measure of core

Chart VI.5: Major Contributors to WPI Inflation in June 2010 (y-o-y)

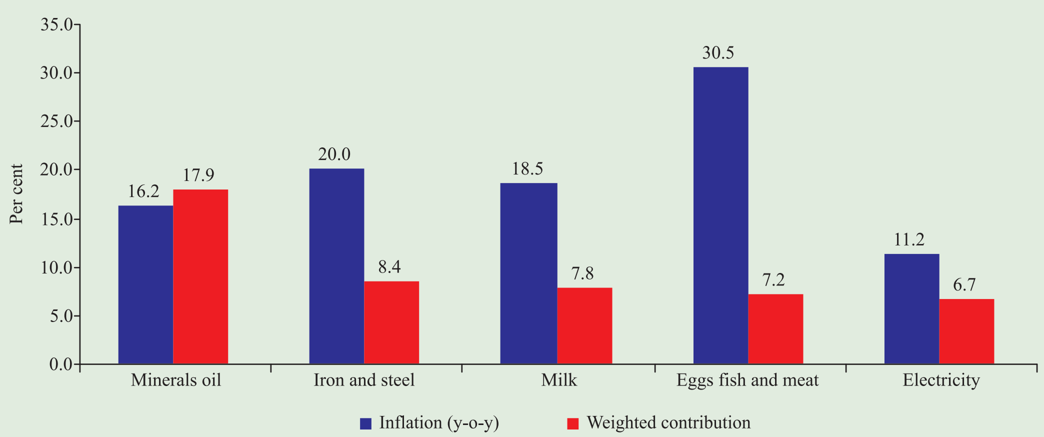
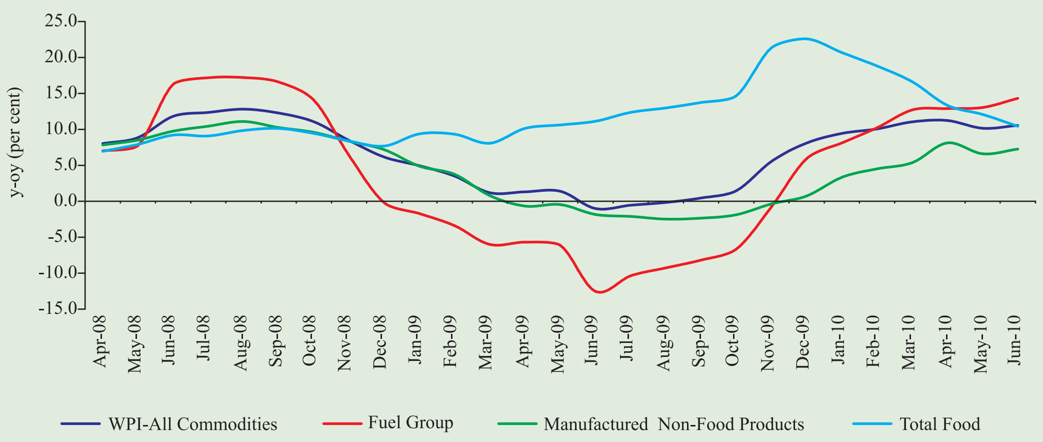


Chart VI.6: WPI Inflation: Major Sub-categories



component, however, has moved in sync with the headline inflation.

VI.14 A major part of the increase in inflation in recent months could be attributed to a number of changes in administered prices of several products. With upward revision in administered prices, the suppressed inflation became more open, leading to increase in overall inflation (Chart VI.8). Between November 2009 and June 2010, WPI has increased by about 5.1 per cent, and changes in administered prices and lagged reporting of earlier increases in prices have contributed as much as 42 per cent of the increase in WPI (Table VI.2). The full impact of the revision in administered prices of petroleum products effected in June 2010 will be reflected largely in WPI for July 2010.

VI.15 Amongst the major groups, primary articles inflation, y-o-y, has increased significantly since October 2009, mainly on account of food prices, which registered high double-digit increase (Chart VI.7b). Some

Chart VI.7: Annual WPI Inflation

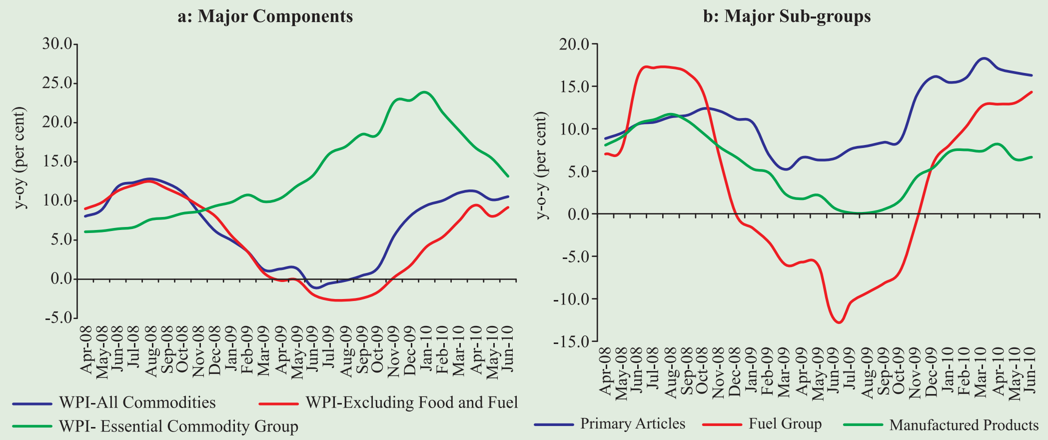
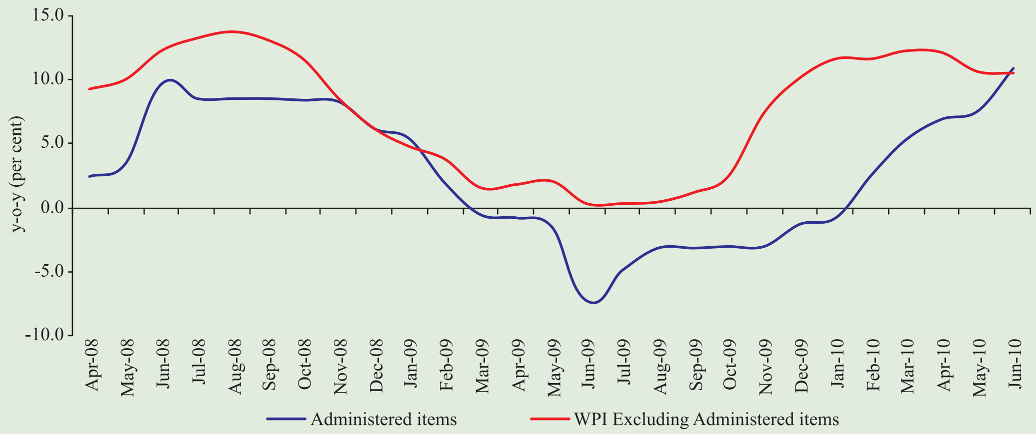


Chart VI.8: Administered and Non-administered Price Inflation



softening of inflation in primary articles is visible in recent months reflecting the seasonal moderation in prices of food articles. The moderation in food inflation in June 2010 partly reflected the base effect. Primary articles inflation had increased significantly in March 2010 as sugarcane price index was revised upwards by about 50 per cent after keeping almost unchanged for two years and thus reflected the effect of lagged reporting of past increases in prices.

Table VI.2: Impact of Administered Price Changes Effected Since November 2009 on WPI Inflation

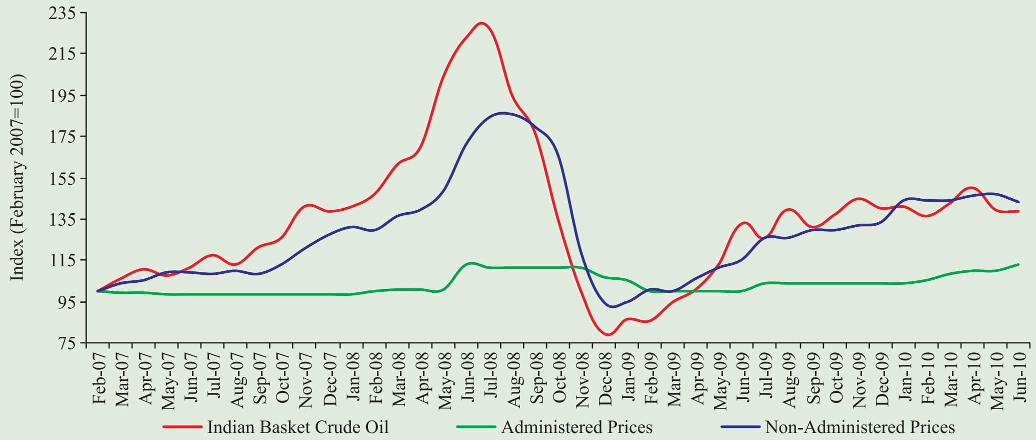
Item	Increase (in per cent)	Contribution to WPI inflation in basis points
1	2	3
LPG*	6.5	17
Petrol*	9.3	08
Diesel*	10.3	40
Kerosene*	8.9	09
Coal	13.5	24
Electricity	6.2	38
Fertiliser	4.5	13
Impact of revision of sugarcane index	50.6	63
Total Impact		**212**

* : Includes impact of tax changes and partial impact of revision in prices effected on June 25, 2010.

The y-o-y inflation in primary articles as on July 10, 2010 was 16.5 per cent.

VI.16 Year-on-year fuel group inflation turned positive in December 2009 reflecting the base effect of downward revision to administered prices effected in December 2008. The reversal of customs and excise duty concessions given on petroleum products in the Union Budget for 2010-11, as part of the fiscal exit, and increases in taxes of petroleum products by certain state governments, led to increases in administered prices of petroleum products. Freely priced products under the minerals oil group usually track the trends in international crude prices (Chart VI.9). A significant gap in the administered prices of petroleum products in relation to the price of Indian basket crude oil (converted to rupees at respective monthly average exchange rates) increased the under-recoveries of oil marketing companies and the burden on the fiscal situation. As the consumption growth of petroleum products is also expected to pick-up with increase in growth momentum, the fiscal burden could have increased further, even with stable

Chart VI.9: Fuel Price Pass-through



international prices. Motivated by fiscal as well as fuel efficiency considerations, the Government increased the price of diesel (by Rs.2 per litre), PDS kerosene (by Rs.3 per litre) and domestic LPG (by Rs.35 per cylinder) and deregulated petrol prices on June 25, 2010. The direct impact of these measures are expected to cause about 0.9 percentage point increase in WPI inflation, with the indirect impact on prices through input cost escalation with a lag likely to raise the full impact to about 2 percentage points, assuming partial pass-through. The WPI inflation figures for June 2010 reflects only part of the direct impact. As on July 10, 2010, the y-o-y fuel group inflation was at 14.3 per cent.

VI.17 Manufactured products inflation, year-on-year, though remains lower than food and fuel inflation, has increased since August 2009 and was at 7.4 per cent in March 2010, driven by inflation in manufactured food products. Since then, manufactured food inflation has declined to 4.3 per cent in June 2010 from 15.5 per cent in March 2010, led by lower inflation in sugar and decline in edible oil and oil cakes prices. Manufactured non-food products inflation, however, accelerated from -0.4 per cent in November 2009 to 7.3 per cent in June 2010 (Table VI.3).

VI.18 Domestic price trends in several commodities have been quite different from corresponding international trends (Table VI.4). Despite decline in inflation in recent months in several food items internationally, their prices have not come down to levels that were prevailing in the pre-global crisis period. This suggests why import as an option for domestic price control is still not available to India for several essential items (Chart VI.10).

Consumer Price Inflation

VI.19 Inflation, as measured by various consumer price indices, has exhibited some moderation since January 2010 as food price inflation witnessed some softening. CPI inflation, however, remained high in the range of 13.0-14.1 per cent during May-June 2010 (Table VI.5).

Table VI.3: Wholesale Price Inflation in India (Year-on-Year)

(Per cent)

Commodity	Weight	2009-10 (March) Inflation	2009-10 (March) C*	2010-11 (June) P Inflation	2010-11 (June) P C*	Financial Year (over March 2010) Inflation	Financial Year (over March 2010) C*
1	2	3	4	5	6	7	8
All Commodities	**100.0**	**11.0**	**11.0**	**10.6**	**10.6**	**2.5**	**2.5**
1. Primary Articles	**22.0**	**18.3**	**4.4**	**16.3**	**4.0**	**2.9**	**0.7**
Food Articles	15.4	17.4	2.9	14.6	2.5	3.1	0.5
i. Rice	2.4	8.2	0.2	6.4	0.2	-0.2	0.0
ii. Wheat	1.4	14.9	0.2	4.5	0.1	-7.2	-0.1
iii. Pulses	0.6	31.3	0.2	32.6	0.2	7.2	0.1
iv. Vegetables	1.5	2.6	0.0	0.0	0.0	51.7	0.6
v. Fruits	1.5	17.2	0.3	10.9	0.2	-18.8	-0.1
vi. Milk	4.4	17.7	0.8	18.5	0.8	2.9	0.1
vii. Eggs, Fish and Meat	2.2	31.0	0.7	30.5	0.8	5.3	0.2
Non-Food Articles	6.1	24.7	1.5	18.6	1.2	1.8	0.1
i. Raw Cotton	1.4	18.3	0.2	16.3	0.2	4.4	0.1
ii. Oilseeds	2.7	10.2	0.3	4.2	0.1	1.5	0.0
iii. Sugarcane	1.3	53.2	0.7	53.2	0.7	0.0	0.0
Minerals	0.5	1.3	0.0	28.5	0.3	5.7	0.1
2. Fuel, Power, Light and Lubricants	**14.2**	**12.7**	**2.5**	**14.3**	**2.8**	**3.5**	**0.7**
i. Coal Mining	1.8	13.5	0.3	13.5	0.3	0.0	0.0
ii Minerals Oil	7.0	17.0	2.0	16.2	1.9	2.7	0.3
iii. Electricity	5.5	4.7	0.3	11.2	0.7	6.2	0.4
3. Manufactured Products	**63.7**	**7.4**	**4.1**	**6.7**	**3.7**	**1.9**	**1.0**
i. Food Products	11.5	15.5	1.7	4.3	0.5	-3.7	-0.4
of which: Sugar	3.6	44.6	1.3	18.4	0.6	-8.4	-0.3
Edible Oils	2.8	-2.9	-0.1	-1.9	0.0	0.1	0.0
ii. Cotton Textiles	4.2	16.8	0.5	18.8	0.6	4.5	0.2
iii. Man Made Fibres	4.4	3.5	0.1	7.1	0.1	3.7	0.1
iv. Chemicals and Products	11.9	8.0	0.9	5.8	0.7	3.1	0.3
of which : Fertilisers	3.7	-4.7	-0.2	3.1	0.1	7.8	0.2
v. Non-Metallic Mineral Products	2.5	2.0	0.0	-1.2	0.0	-1.6	0.0
of which: Cement	1.7	-1.4	0.0	-5.8	-0.1	-2.6	0.0
vi. Basic Metals, Alloys and Metal Products	8.3	2.4	0.2	12.1	1.1	8.8	0.8
of which: Iron and Steel	3.6	4.2	0.2	20.0	0.9	14.4	0.6
vii. Machinery and Machine Tools	8.4	3.2	0.2	3.9	0.2	0.4	0.0
of which: Electrical Machinery	5.0	2.7	0.1	3.8	0.1	0.3	0.0
viii. Transport Equipment and Parts	4.3	0.7	0.0	2.4	0.1	1.6	0.0
Memo:							
Food Items (Composite)	**26.9**	**16.6**	**4.6**	**10.4**	**3.0**	**0.4**	**0.1**
Manufactured Non-food Products	**52.2**	**5.4**	**2.4**	**7.3**	**3.2**	**3.4**	**1.5**
WPI Excluding Food	**73.1**	**8.9**	**6.5**	**10.6**	**7.6**	**3.4**	**2.4**
WPI Excluding Fuel	**85.8**	**10.6**	**8.5**	**9.6**	7.7	**2.3**	**1.8**
WPI Essential Commodities Group	**17.6**	**19.0**	**3.4**	**13.2**	**2.4**	**-0.3**	**-0.1**

*: Contribution to inflation in percentage points. P: Provisional.

Table VI.4: International Commodity Prices

Commodity	Unit	Market Price (2004)	Index (2004=100)						Variation (Per cent)
			2006	2007	2008	Mar-09	Mar-10	Jun-10	Jun-10 Over Jun-09
1	2	3	4	5	6	7	8	9	10
Energy									
Coal	$/mt	53	93	124	240	115	178	185	37.6
Crude oil	$/bbl	38	170	188	257	124	210	198	8.1
Non-Energy Commodities									
Palm oil	$/mt	471	101	165	201	127	177	169	9.9
Soybean oil	$/mt	616	97	143	204	118	149	139	-4.1
Soybeans	$/mt	307	88	125	171	124	133	133	-19.1
Rice	$/mt	238	128	137	274	247	211	185	-23.4
Wheat	$/mt	157	122	163	208	147	122	101	-38.6
Maize	$/mt	112	109	146	200	147	142	137	-14.9
Sugar	c/kg	16	206	141	178	187	260	222	-3.3
Cotton A Index	c/kg	137	93	102	115	83	139	146	47.7
Aluminium	$/mt	1716	150	154	150	78	129	113	22.7
Copper	$/mt	2866	235	248	243	131	260	227	29.6
Gold	$/toz	409	148	170	213	226	272	301	30.4
Silver	c/toz	669	173	200	224	196	256	277	26.4
Steel cold-rolled coil sheet	$/mt	607	114	107	159	148	128	140	21.4
Tin	c/kg	851	103	171	217	125	206	203	15.6
Zinc	c/kg	105	313	309	179	116	217	166	11.9

$: US dollar. c: US cent. kg: Kilogram. mt: metric tonne. toz: troy oz. bbl: Barrel.

Source: Based on World Bank's actual commodity price data. The year 2004 has been taken as the base to exhibit price trends over the relevant period.

VI.20 The divergence between WPI and CPI inflation reduced in recent months as CPI inflation declined moderately in recent months while WPI inflation increased significantly (Table VI.5 and Chart VI.11).

Chart VI.10: Global Food Price: FAO Food Price Index

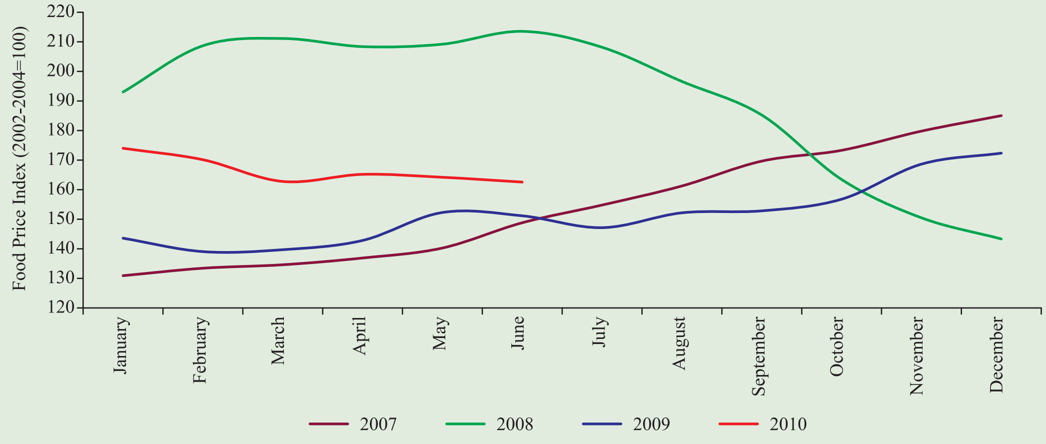


Table VI.5: Consumer Price Inflation - Major Groups

(Year-on-year variation in per cent)

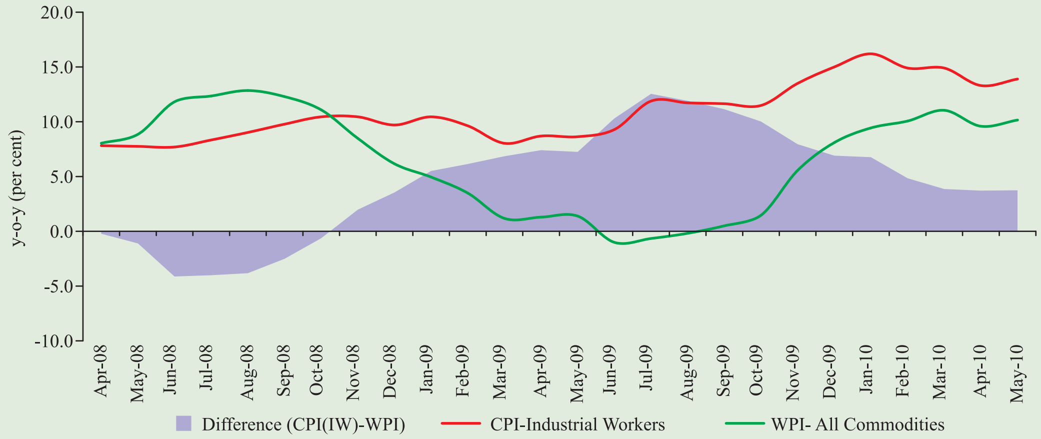
CPI Measure	Weight	Mar-08	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10	Apr-10	May-10	June-10
1	2	3	4	5	6	7	8	9	10	11
CPI-IW (Base: 2001=100)										
General	**100.0**	**7.9**	**8.0**	**9.3**	**11.6**	**15.0**	**14.9**	**13.3**	**13.9**	**–**
Food Group	46.2	9.3	10.6	12.2	13.5	21.3	16.0	14.5	13.6	–
Pan, Supari *etc*.	2.3	10.9	8.3	8.1	8.0	8.6	9.1	11.9	13.9	–
Fuel and Light	6.4	4.6	7.4	1.4	4.2	3.4	3.4	4.8	6.3	–
Housing	15.3	4.7	6.0	6.0	22.1	22.1	33.1	33.1	33.1	–
Clothing, Bedding *etc*.	6.6	2.6	5.0	4.1	4.1	4.1	4.0	4.8	4.0	–
Miscellaneous	23.3	6.3	7.4	6.6	5.7	4.2	4.8	5.5	4.8	–
CPI-UNME (Base: 1984-85=100)										
General	**100.0**	**6.0**	**9.3**	**9.6**	**12.4**	**15.5**	**14.9**	**14.4**	**14.1**	**–**
Food Group	47.1	7.8	12.2	13.6	14.4	21.4	16.3	14.8	14.0	–
Fuel and Light	5.5	4.6	5.9	1.3	4.2	3.5	3.3	4.8	6.3	–
Housing	16.4	4.0	5.8	6.0	22.0	22.0	33.2	33.2	33.2	–
Clothing, Bedding *etc*.	7.0	4.3	3.3	4.2	4.1	4.1	4.0	4.9	4.0	–
Miscellaneous	24.0	4.8	8.6	7.3	6.0	4.6	5.3	5.5	5.2	–
CPI-AL (Base: 1986-87=100)										
General	**100.0**	**7.9**	**9.5**	**11.5**	**13.2**	**17.2**	**15.8**	**15.0**	**13.7**	**13.0**
Food Group	69.2	8.5	9.7	12.4	14.6	20.2	17.7	16.5	14.4	13.7
Pan, Supari *etc*.	3.8	10.4	15.3	14.2	15.5	14.6	15.4	16.4	16.9	16.6
Fuel and Light	8.4	8.0	11.5	11.0	12.0	14.3	15.2	16.0	16.6	15.5
Clothing, Bedding *etc*.	7.0	1.8	7.4	8.3	8.1	8.2	9.1	9.2	9.4	9.6
Miscellaneous	11.7	6.1	6.5	6.1	7.1	7.0	7.6	7.6	7.5	7.7
CPI-RL (Base: 1986-87=100)										
General	**100.0**	**7.6**	**9.7**	**11.3**	**13.0**	**17.0**	**15.5**	**15.0**	**13.7**	**13.0**
Food Group	66.8	8.2	10.0	12.4	14.6	20.4	17.7	16.7	14.6	13.9
Pan, Supari *etc*.	3.7	10.6	15.0	14.1	15.4	14.4	15.5	16.5	17.0	16.7
Fuel and Light	7.9	8.0	11.5	11.0	12.0	14.1	15.0	15.6	16.2	15.3
Clothing, Bedding *etc*.	9.8	2.8	8.2	8.8	9.5	10.3	9.8	10.3	10.2	10.3
Miscellaneous	11.9	6.2	6.7	6.2	6.9	6.6	7.2	7.4	7.3	7.3
Memo:										
WPI Inflation		7.5	1.2	-1.0	0.5	8.1	11.0	11.2	10.2	10.6
GDP Deflator based Inflation*		4.9	7.9	0.9	0.7	5.8	4.5	–	–	–

*: Data for March pertain to full year.

IW : Industrial Workers. UNME : Urban Non-Manual Employees. AL : Agricultural Labourers. RL : Rural Labourers.

VI.21 Overall, the inflationary process, which originated from supply shocks, has now become generalised. Changes in administered prices and lagged reporting of past price increases have added force to the uptrend in WPI in recent months. Given the expected better *kharif* output than last year, food price pressures may moderate during the course of the year. Non-food manufactured products inflation, at 7.3 per cent, is above the comfort level. Along with the observed inflation persistence, emerging demand pressures could add to inflation expectations. Wage revisions to offset the impact of inflation on purchasing power, and use of higher mark ups with

Chart VI.11: CPI and WPI Inflation



return of pricing power of firms, could strengthen the interactions between inflation expectations and actual inflation. This suggests a need to continue the process of normalisation of monetary policy to anchor inflation expectations.

VII. MACROECONOMIC OUTLOOK

Various forward looking surveys conducted in the recent period suggest an overall improvement in business sentiments as also the possibility of further acceleration of growth in 2010-11. The Professional Forecasters' Survey of the Reserve Bank also shows upward revision in the median growth projections for 2010-11. With stronger growth outlook, high generalised inflation has emerged as the key macroeconomic concern. The anti-inflationary monetary policy measures taken so far by the Reserve Bank, coupled with an improved supply position that may result from better performance of kharif relative to last year, could be expected to help in arresting inflation by firmly anchoring inflationary expectations in the coming months.

VII.1 The Indian economy witnessed robust recovery in growth in the last quarter of 2009-10. Most of the business expectations surveys suggest continuation of the growth momentum in 2010-11. The Industrial Outlook Survey of the Reserve Bank indicates further improvement in several parameters of the business environment for the July-September 2010 quarter. The Professional Forecasters' Survey conducted by the Reserve Bank in June 2010 places overall (median) GDP growth rate for 2010-11 at 8.4 per cent, higher than 8.2 per cent reported in the previous round of the survey.

Business Expectations Surveys

VII.2 The forward looking surveys conducted by various agencies generally convey an optimistic picture about the economy. In continuation of the trend observed in recent rounds of surveys, the latest round of most of the surveys also shows strong y-o-y as well as q-o-q improvement. (Table VII.1).

VII.3 NCAER-MasterCard Worldwide Index of Business Confidence points to continuation of high level of optimism notwithstanding a marginal decline in the index. The optimism is led by sustained recovery in the industrial activity and improvement in merchandise export during April-May 2010, which contributed to the expectation that the overall GDP growth in the first quarter of 2010-11 may exceed 8.5 per cent. At the same time, there are concerns that persistence of double digit inflation may affect consumption and

Table VII.1: Business Expectations Surveys

Period/Index	NCAER-MasterCard Worldwide Index of Business Confidence June 2010	FICCI Q4:2009-10 Overall Business Confidence Index	Dun & Bradstreet Q3: 2010 Business Optimism Index	CII Apr.-September 2010-11 Business Confidence Index
1	2	3	4	5
Current level of the Index	155.9	74.8	150.0	67.6
Index as per previous survey	156.8	70.0	142.8	66.1
Index levels one year back	118.6	64.1	132.1	58.7
% change (q-o-q) sequential	-0.6	6.9	5.0	2.3
% change (y-o-y)	31.5	16.7	13.6	15.2

investment demand and also lead to policy response that could increase the cost of credit and funds.

VII.4 The latest round of Business Confidence Survey of the FICCI suggests that 87 per cent of the companies view the overall economic conditions as "moderately to substantially better". Going ahead, around 82 per cent of the companies foresee an improvement in overall economic conditions in the coming six months. The outlook for jobs has been somewhat subdued, with about two-thirds of the participants anticipating no change in employment levels in the coming six months, even though about 30 per cent firms expect an increase in their employee strength in the coming six months.

VII.5 The Dun and Bradstreet Business Optimism Survey recorded sustained improvement, which at a two year high, is reflective of the continuous strengthening of confidence amongst corporates. Robust growth in industrial production, stabilising domestic consumption demand, rapidly growing investment demand coupled with increase in imports and exports seem to have supported the growing business confidence. Five out of the six optimism indices, *viz.*, volume of sales, net profits, new orders, inventory levels and employee levels have registered an increase as compared to the previous quarter. However, selling prices recorded a decline as compared to the previous quarter. Demand conditions are expected to witness significant improvement in the medium to long-term and employment scenario is expected to improve in the July-September 2010 quarter.

VII.6 The CII Business Confidence Survey for April-September 2010-11 suggested growing confidence of respondents about expansion of exports over the next six months. Headline inflation touching double digits emerged as a major concern, while the respondents felt that procedural delays need to be addressed urgently.

VII.7 The seasonally adjusted HSBC Markit Manufacturing Purchasing Managers' Index (PMI), which had recorded a twenty-seven month high in May 2010, witnessed a marginal fall in June 2010, mainly reflecting slower growth in output and new orders, even though the pace of new export orders accelerated. On the downside, the employment levels remained stagnant. Notwithstanding the recent fall, the index has remained in the above neutral territory (*i.e.*, above 50) in each of the past fifteen months.

VII.8 The HSBC Markit Services PMI accelerated sharply to reach a two year high in June 2010, indicating optimism and continuation of higher levels of activity in the services sector. India is one of the few countries that showed an improvement in the services PMI in June 2010. The employment scenario also improved and the output prices continued to rise at accelerated pace, thus suggesting continuation of pricing pressures. The growth in services sector offset the weakness in manufacturing sector and, as a result, the composite output index registered the sharpest rise in almost two years.

Reserve Bank's Industrial Outlook Survey

VII.9 The 50th round of the Industrial Outlook Survey of the Reserve Bank conducted during April-June 2010, based on a sample of 1,092 companies, suggested a moderate slowdown in the index, both for the assessment quarter (April-June 2010) as well as expectations for the July-September 2010 quarter. However, both indices (*i.e.*, assessment about the current quarter and expectations about the next quarter) remained in the growth terrain (*i.e.*, above 100, which is the threshold that separates contraction from expansion) (Chart VII.1a). Most of the parameters of the survey indicate buoyancy in business environment (Table VII.2). The findings of the survey are in line with the forward looking manufacturing PMI survey (Chart VII.1b).

Survey of Professional Forecasters

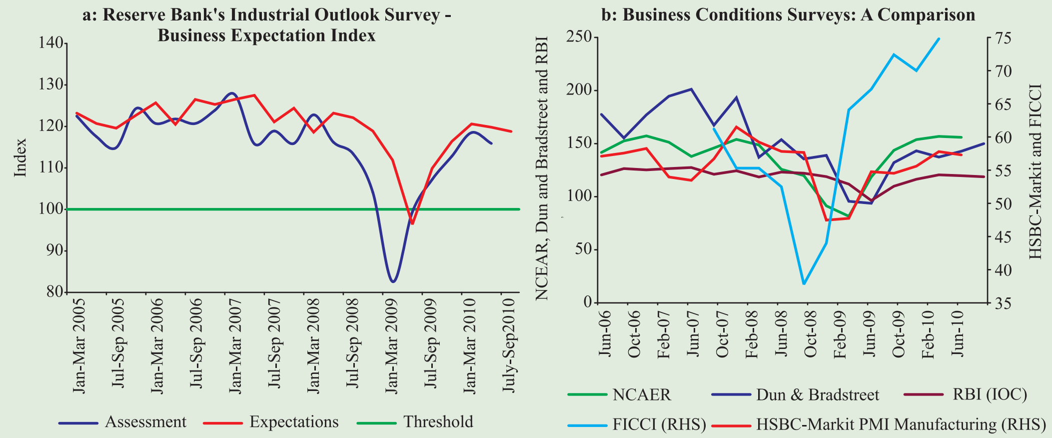
VII.10 The results of the twelfth round of "Survey of Professional Forecasters" conducted by the Reserve Bank in June 2010 shows overall (median) GDP growth rate

Table VII.2: Reserve Bank's Survey -Net Response on Expectations and Assessment about the Industrial Performance

Parameter	Optimistic Response	Jul-Sept 2009		Oct-Dec 2009		Jan-Mar 2010		Apr-Jun 2010		July-Sep 2010
		E	A	E	A	E	A	E	A	E
1	2	3	4	5	6	7	8	9	10	11
1 Overall business situation	Better	24.2	26.3	39.8	36.0	44.9	43.1	41.2	40.7	41.5
2 Financial situation	Better	20.0	21.8	33.5	29.5	39.3	35.8	36.3	32.2	34.1
3 Working capital finance requirement	Increase	26.3	23.8	30.4	28.8	32.7	30.5	27.7	29.9	31.1
4 Availability of Finance	Improve	16.6	19.2	26.1	23.0	29.2	25.7	26.8	26.4	28.5
5 Cost of external finance	Decrease				-14.7	-18.3	-15.9	-20.6	-21.9	-23.3
6 Production	Increase	22.4	22.6	35.0	28.9	40.0	36.5	35.9	35.4	40.2
7 Order books	Increase	16.8	20.5	32.3	25.9	35.8	31.9	33.4	31.3	36.3
8 Pending orders, if applicable	Below normal	19.1	17.4	11.0	11.6	5.7	8.8	6.4	6.9	4.2
9 Cost of raw material	Decrease	-27.1	-41.7	-38.4	-47.1	-44.3	-60.2	-48.6	-62.7	-49.3
10 Inventory of raw material	Below average	-0.5	-2.1	-1.2	-4.2	-3.6	-5.8	-2.6	-5.0	-5.1
11 Inventory of finished goods	Below average	-1.8	-4.3	-3.7	-4.3	-1.9	-4.3	-2.6	-4.1	-5.0
12 Capacity utilisation (main product)	Increase	10.7	10.1	22.0	16.5	25.4	21.7	19.7	21.1	26.5
13 Level of capacity utilisation (compared to the average in the preceding four quarters)	Above normal	-12.1	-11.2	-3.8	-3.9	1.3	3.0	1.6	2.5	5.8
14 Assessment of the production capacity (with regard to expected demand in the next six months)	More than adequate	5.5	5.8	6.5	5.3	5.0	6.4	7.1	3.1	4.1
15 Employment in the company	Increase	1.5	4.1	8.8	10.3	12.1	13.7	13.6	14.7	16.8
16 Exports, if applicable	Increase	0.1	-2.9	12.5	9.2	20.2	12.7	18.5	15.3	20.7
17 Imports, if any	Increase	4.6	7.8	11.5	13.0	16.9	17.1	17.1	20.9	21.7
18 Selling prices are expected to	Increase	0.0	0.2	6.0	2.6	9.8	12.4	13.3	17.3	15.2
19 Increase in selling prices, if any, is expected	Increase at lower rate	-100.0	23.2	19.4	19.3	16.8	21.6	19.7	17.4	14.3
20 Profit margin	Increase	-13.4	-15.1	-2.8	-9.9	1.1	-2.9	3.2	-4.8	3.1

Note: 1. 'Net response' is measured as the percentage share differential between the companies reporting 'optimistic' (positive) and 'pessimistic' (negative) responses; responses indicating *status quo* (no change) are not reckoned. Higher 'net response' indicates higher level of confidence and *vice versa*.
2. E: Expectations and A: Assessment.
3. 'Cost of external finance' is a newly added question from the 48th (October – December 2009) survey round.

Chart VII.1: Industrial Outlook Surveys



for 2010-11 at 8.4 per cent, as against 8.2 per cent reported in the previous survey (Table VII.3). The sectoral growth rate forecast for the agriculture sector was revised marginally upwards from 4.0 per cent to 4.1 per cent. For the services sector also

Table VII.3: Median Forecasts of Select Macroeconomic Indicators by Professional Forecasters 2010-11

	Actual 2009-10	Annual Forecasts 2010-11		Annual Forecasts 2011-12		Quarterly Forecasts 2010-11 Q1		Q2		Q3		Q4		2011-12 Q1	
		E	L	E	L	E	L	E	L	E	L	E	L	E	L
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
1. Real GDP growth rate at factor cost (in per cent)	7.4 R	8.2	8.4	–	8.5	8.1	8.7	8.3	8.2	8.4	8.5	8.5	8.4	–	8.3
a. Agriculture and Allied Activities	0.2 R	4.0	4.1	–	3.0	2.9	2.7	3.8	4.0	5.7	6.0	4.3	3.9	–	3.0
b. Industry	10.4 R	9.0	9.0	–	9.1	10.6	11.6	9.3	9.3	9.0	8.7	8.5	8.4	–	8.7
c. Services	8.3 R	9.0	9.1	–	9.5	8.9	9.1	8.8	8.9	9.7	9.3	9.9	9.2	–	9.5
2. Gross Domestic Saving (per cent of GDP at current market price)	–	35.3	34.7	–	35.9	–	–	–	–	–	–	–	–	–	–
3. Gross Domestic Capital Formation (per cent of GDP at current market price)	–	38.0	36.0	–	37.8	37.0	36.8	38.0	36.8	38.7	36.3	38.8	36.1	–	37.3
4. Corporate profit after tax (growth rate in per cent)*	28.8	20.0	22.5	–	21.0	18.5	20.0	18.8	18.0	18.4	18.9	26.1	25.0	–	25.0
5. Inflation WPI	3.8	7.0	8.6	–	6.0	9.5	10.4	8.0	9.5	6.7	8.1	5.7	7.0	–	6.4
6. Exchange Rate (INR/US$ end period)	45.1	44.0	44.5	–	43.5	45.0	46.3	44.8	45.5	44.6	44.8	44.1	44.5	–	43.8
7. T-Bill 91 days Yield (per cent-end period)	4.4	5.3	5.2	–	5.0	–	–	–	–	–	–	–	–	–	–
8. 10-year Govt. Securities Yield (per cent-end period)	7.2	8.0	7.8	–	7.5	–	–	–	–	–	–	–	–	–	–
9. Export (growth rate in per cent)!	-4.7 P	15.0	15.0	–	16.0	–	–	–	–	–	–	–	–	–	–
10. Import (growth rate in per cent)!	-8.2 P	18.0	17.9	–	15.0	–	–	–	–	–	–	–	–	–	–
11. Trade Balance (US$ billion)	-102.1 P	–	–	–	–	-32.7	-32.8	-34.6	-34.5	-35.5	-36.5	-32.1	-33.0	–	-35.9

E: Previous Round Projection. L: Latest Round Projection. R: Revised Estimate. P: Preliminary Estimate.
–: Not Available. * : BSE listed companies. ! : US$ on BoP basis.

Note: The latest round refers to twelfth round for the quarter ended June 2010, while previous round refers to eleventh round for the quarter ended March 2010.

Source : Survey of Professional Forecasters, First Quarter 2010-11.

Table VII.4: Agencies' Forecast for 2010-11

Agency	Latest Projection		Earlier Projection	
	Real GDP Growth (Per cent)	Month	Real GDP Growth (Per cent)	Month
1	2	3	4	5
Economic Advisory Council to the PM	8.5	July-10	8.2	Feb-10
Ministry of Finance	8.5 (+/-0.25)	Feb-10	..	..
IMF (calendar year)	9.4	July-10	8.8	April-10
ADB	8.2	July-10	8.2	April-10
NCAER	8.1	April-10	..	..
OECD	8.3	May-10	7.3	Nov-09

.. : Not available.

the assessment was revised marginally upwards from 9.0 per cent to 9.1 per cent. For industry, the forecast remained unchanged at 9.0 per cent.

Growth Projections of Different Agencies

VII.11 All available projections of real GDP growth for 2010-11 are higher than 8 per cent. The IMF's projected growth figure for India may seem to be on the higher side but it is not so as it is at constant market prices. (Table VII.4 and Box VII.1).

Factors Influencing the Current Growth and Inflation Outlook

VII.12 The economic recovery witnessed in 2009-10 after the slowdown in 2008-09 was mainly driven by a turnaround in the industrial output, with continued resilience of the services sector. The leading indicators point to the prospect of robust growth in the coming quarters and fast closing of the output gap. An uncertain external environment, however, is a major risk to growth in the near term.

Box VII.1: GDP Growth at Factor Cost and Market Prices

The growth projections generated by different agencies, both in India and outside reflect the divergence in their assessments. The difference in growth estimates across agencies provides a broader perspective to the market, though at times they may not be exactly comparable. While most of the projected growth numbers, including those released by the Reserve Bank are at factor cost, the IMF's recent projection for India's growth in 2010 is at market prices and also relates to the calendar year. GDP growth at market prices may differ significantly from GDP growth at factor cost depending on the trend in "indirect taxes net of subsidies". For example, GDP growth at factor cost in 2008-09 at 6.7 per cent was higher than GDP growth at market prices (5.1 per cent). In contrast, GDP growth at factor cost in 2009-10 was lower at 7.4 per cent as compared with 7.7 per cent at market prices. During the fourth quarter of 2009-10, the difference was particularly high with GDP at market prices growing at 11.2 per cent as against the growth of 8.6 per cent at factor cost. The IMF's 9.4 per cent projected growth for the calendar year 2010 factors in the turnaround in taxes in January-March 2010.

VII.13 The growth outlook for the Indian economy for 2010-11 remains positive on account of the following factors: (a) prospect of better *kharif* output than last year, (b) buoyancy in the industrial sector, notwithstanding the moderation in May 2010, (c) stronger growth in corporate sales with higher profitability, (d) improving business environment as per optimism expressed in different surveys, (e) strong growth in exports, notwithstanding weakness in global conditions, (f) indications of pick-up in private consumption demand, as evident from trends in production of consumer durables and non-durables as also auto sales, (g) significant pick-up in investment demand, (h) stronger growth in lead indicators of services sector like tourist arrivals, commercial vehicles production and railway freight traffic, (i) a potentially lower fiscal deficit due to the favourable outcome of the 3G/ BWA spectrum auctions, which could create greater space for private sector investment, and (j) significant acceleration in credit demand from the private sector.

VII.14 Notwithstanding the upside prospects, certain downside risks remain: (a) as the export growth hinges on external demand conditions, given the asymmetry in growth outlook for advanced economies and EMEs, sustaining high export growth would be challenging, (b) real appreciation of the exchange rate could also weaken external price competitiveness of Indian exports, (c) even though investment demand accelerated sharply in Q4 of 2009-10, it needs to be sustained to return to the pre-global crisis trajectory, (d) while private consumption demand has shown signs of revival, sustenance of the trend is crucial, given the gradual phasing out of the fiscal stimulus and the monetary exit, and (e) the inflationary pressures, besides affecting the cost structure through demands for higher wages and increase in input costs, could also depress demand.

VII.15 Headline inflation, which reached 10.6 per cent in June 2010, has been in double digits for last five months and is also increasingly getting generalised. Even though recent upward revisions in administered prices have added to inflation, demand side pressures are also building up. Going forward, factors which may exert further upward pressure on inflation are: (a) return of pricing power in step with the pick-up in private demand and faster closing of capacity utilisation gap may add further pressure on investment demand, (b) recent measures to align domestic fuel prices with the international prices; while the first round impact of the rise in fuel prices is presently becoming evident, the indirect impact would be felt with a lag, (c) possible wage pressures, and (d) recent increase in minimum support prices.

VII.16 Given these risks, the factors that may help in restraining the inflationary pressures include: (a) better *kharif* production, thereby easing the supply side constraints in agricultural production, (b) indications of stable global commodity prices, especially that of oil and food, and (c) the impact of monetary policy actions already initiated by the Reserve Bank to contain inflation and anchor inflationary expectations.

VII.17 An overall assessment suggests that the GDP growth will be higher than 8 per cent projected in the April 2010 Monetary

Policy Statement, as the upside bias has materialised. The major policy concern, therefore, would be to contain the inflationary pressures and anchor inflationary expectations. The acceleration in growth seen so far needs to become self-sustaining, with durable pick-up in both private consumption and investment demand. Moreover, uncertainties in the external environment cannot be overlooked. Hence, the calibrated approach to normalisation of monetary policy continues to be appropriate. Given the risk to inclusive growth from high inflation, the monetary unwinding that started in October 2009 should continue till inflation expectations are firmly anchored and inflation is brought down.

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