I Overview

Macroeconomic Developments : 2001-02

1.1 Macroeconomic prospects for the year 2001-02 remain uncertain with the behaviour of various indicators of economic activity belying the initial expectations of an early upturn. The prevailing uncertainty was reflected in the revisions in growth forecasts for India for the year by various entities ranging widely from 4.5 to over 6.0 per cent.

1.2 According to the Quarterly Estimates of Gross Domestic Product (GDP) released by the Central Statistical Organisation (CSO), the growth rate of real GDP at 5.3 per cent in the second quarter of the financial year 2001-02 showed an improvement over 4.4 per cent recorded during the first quarter. However, the growth performance recorded during the first half of the current year remained below the growth rate achieved during the first half of 2000-01. The deceleration during the first half of the current year indicates that the slowdown which began with a decline in the growth rate from 6.6 per cent in 1998-99 to 6.4 per cent in 1999-2000 and then to 5.2 per cent in 2000-01 has continued to persist. The agricultural sector, however, recorded a distinct improvement in performance, supported by a well-distributed monsoon. The *kharif* foodgrains production touched a new peak in 2001-02. There has been noteworthy improvement in the production of key non-foodgrains such as oilseeds and cotton. The *rabi* production is also expected to improve over last year's level on account of a favourable North-East monsoon. Procurement operations have raised the stock of foodgrains to the level of 59.1 million tonnes at the end of November, 2001. The ongoing deceleration of growth has mainly reflected the sharp slowdown in the industrial sector. The index of industrial production rose by barely 2.2 per cent during the period April-October, 2001-02 as against 5.9 per cent during the corresponding period of the previous year. The slackening of growth was visible across all major sectors - manufacturing and electricity generation - with mining recording a low growth of 0.5 per cent. Business sentiment remained depressed and the capital markets witnessed subdued investors' interest. First quarter GDP originating in the service sector posted a growth of 6.4 per cent, reversing five consecutive quarters of deceleration. The improvement in services GDP continued in the second quarter of 2001-02 as it grew by 7.2 per cent. During the second quarter, a moderate improvement in growth was recorded by 'agriculture and allied activities', 'electricity, gas and water supply' and 'financing, insurance, real estate and business services' as compared to their growth in the corresponding quarter of 2000-01. Other sectors witnessed declines in their growth during the same period. The recent sectoral developments have ushered in shifts in the composition of GDP as well as in relative contributions to the overall growth process (Chart I.1).

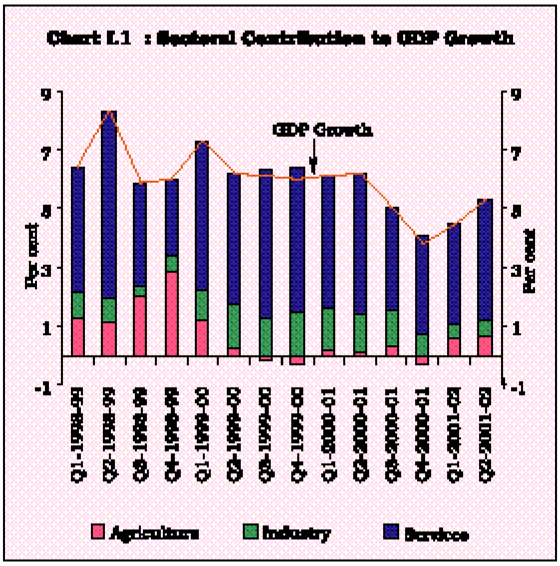
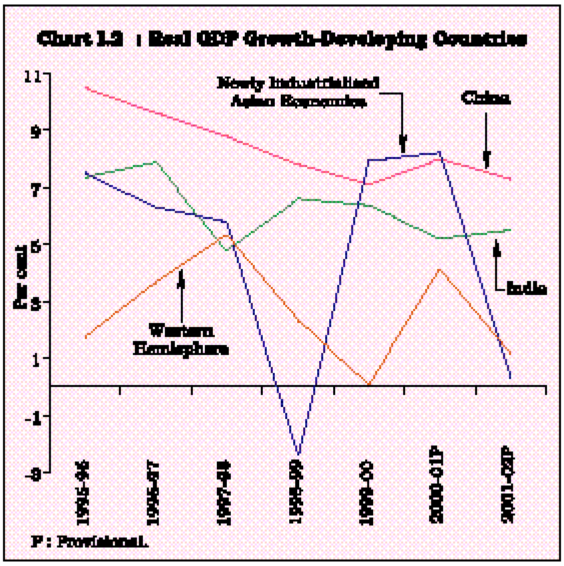


Chart I.1 : Sectoral Contribution to GDP Growth

1.3 The budgetary position of the Centre is experiencing some stress from a cyclical decline of receipts, dampened disinvestments and expansion in expenditure relative to budget estimates. The gross fiscal deficit (GFD) of the Centre is placed at Rs.79,133 crore in April-November, 2001, higher by 23.1 per cent over the level in the first eight months of 2000-01. Inflation conditions turned benign in the absence of demand pressures as well as the supply shocks - revision in fuel prices - which characterised the previous year. Headline inflation fell to a low of 2.2 per cent as on December 22, 2001 as against 8.6 per cent, a year ago; while underlying inflation, reflected in the movement of average wholesale prices also remained lower than the preceding year's level. Reserve money increased by 3.7 per cent during 2001-02 (up to December 28, 2001) as against an increase of 1.7 per cent during the corresponding period of the previous year. The increase in reserve money growth during 2001-02 has been mainly on account of expansion in the net foreign assets of the Reserve Bank. On the other hand, the net domestic assets continued to decline on account of low recourse to refinance and the offsetting of primary monetisation through strategic open market operations. Broad money (M_3), during the current fiscal year (up to December 14), grew by 10.4 per cent, marginally higher than the growth of 9.7 per cent (net of India Millennium Deposits (IMDs)) during the comparable period of the previous year. On an annual basis, M_3 growth was marginally higher at 15.0 per cent as on December 14, 2001 as against 14.7 per cent (net of IMDs) as on December 15, 2000. Growth in net bank credit to the Government, on a fiscal year basis, remained more or less steady at around 13.0 per cent. Non-food credit, adjusted for scheduled commercial banks' non-SLR investments, decelerated to 11.8 per cent from 18.7 per cent last year, on an annual basis, reflecting the industrial slow down.



1.4 Financial markets reflected the slack in real activity, but remained orderly in view of comfortable liquidity conditions. Call rates were range-bound by the liquidity adjustment facility (LAF) operations. Significant reductions in the Bank Rate and cash reserve requirements in October 2001 drove the call rate down to 3.7 per cent on November 6, 2001 - a low for the year so far - although it has firmed up thereafter. Interest rates on other money market instruments also declined. In the absence of any significant pressure from non-food credit demand, around 98 per cent of the Centre's budgeted gross borrowing programme for 2001-02 was absorbed in the primary segment of the Government securities market by December 28, 2001. The secondary market has been driven by large rallies reflecting surplus liquidity conditions leading to the yield curve shifting downwards and the yield on the benchmark 10-year paper reaching a historic low of 7.8 per cent on December 5, 2001. Subsequently, however, conditions in the gilt market turned volatile with the yields hardening by the end of December 2001. The foreign exchange market was relatively stable during 2001-02 with some fluctuations witnessed during the middle of September after the terrorist attacks in the US; however, stability returned rapidly. Stock prices tended to move generally downward between April-September 2001, with the BSE Sensex touching a 8-year low of 2600 on September 21, 2001 in the wake of market uncertainties. There has been some improvement in the market sentiment in the following months with the BSE Sensex strengthening to 3288 by end-November but thereafter declined to 3262 by end-December following border tensions.

1.5 India's real growth is forecast at 5-6 per cent for the financial year 2001-02 (Reserve Bank of India, October 2001), making it one of the few developing countries which weathered the sharp downturn in global economy (Chart I.2). According to the World Economic Outlook (WEO) of the International Monetary Fund (IMF), global growth for 2001 is now projected at 2.4 per cent and the expectations of an early recovery have also dissipated (December 2001). World trade is expected to grow by 1.0 per cent in 2001 as against 12.4 per cent in the previous year. Reflecting the depressed global demand conditions, India's exports increased only by 0.5 per cent during the first eight months of 2001-02 as against the increase of 21.0 per cent in April-November, last year. POL imports declined by 13.4 per cent while, non-POL imports increased by 8.4 per cent.

1.6 The current account deficit narrowed significantly to US $ 938 million in the first half of 2001-02 as compared with US $ 2,865 million in April-September, 2000 on account of sharp decline in imports. Capital flows during the current year were higher than in the preceding year on account of larger net inflows under foreign direct investment, portfolio investment by foreign institutional investors (FIIs) and external assistance. Reflecting these developments, the foreign exchange reserves rose to US $ 48.1 billion as on December 31, 2001, higher by US $ 5.8 billion over the level of US $ 42.3 billion at end-March 2001 (Table 1.1).

Table 1.1: Macroeconomic Indicators

(per cent)

Indicator	2000-01	2001-02 (fiscal year so far)	2000-01 (corresponding period last year)
1	2	3	4
Real GDP	5.2	5.3 $	6.2 $
Agriculture and Allied Activities	0.2	3.4 $	0.5 $
Industry	5.3	2.4 $	5.4 $
Services	7.5	7.2 $	8.5 $
Index of Industrial Production (IIP)	5.1	2.2 (up to October)	5.9
Foodgrains Production (mt)	196.1	105.6 (*kharif*)	103.1 (*kharif*)
Food Stocks (mt)	45	59.1 (end-November)	44.5 (end-November)
GFD/GDP (ratio)	5.1 (RE)	2.3 (up to September)	1.9
Broad Money (M3)	16.7	10.4 (up to Dec. 14)	12.0
Net Bank Credit to the Government	16.1	13.0 (up to December 14)	13.1
Scheduled Commercial Banks' Non-food Credit (Adjusted for non-SLR Investments)#	16.0	11.8 (as on December 14)	18.7
WPI Inflation (Annual point-to-point)	4.9	2.2 (as on December 22)	8.6 (as on December 23)
Call Money Borrowing Rate (weighted average)	9.15	7.08 (December)	8.76 (December)
Yield on 10-Year Government Securities##	10.23 (end-March)	8.0 (end-December)	10.94 (end-December)
BSE Sensex (Average)	4269	3283 (up to December)	4330 (up to December)
Exchange Rate (Rupee/US$)	46.64 (as on end March)	48.18 (as on December 31, 2001)	46.75 (as on December 29, 2000)
Export Growth Rate (US $ terms)	21.0	0.5 (up to November)	21.0
Import Growth Rate (US $ terms)	1.7	1.2 (up to November)	7.4
Current Account Deficit (US $ million)	-2,579	-938 (up to September)	-2,865

Foreign Investment inflow (US $ million)	5,099	3,294 (up to October)	2,314
Non-Resident Deposits inflow (US $ million)	2,317	1,522 (up to October)	1,125
Foreign Exchange Reserves* (US $ million)	42,281	48,112 (December 31, 2001)	40,077 (December 30, 2000)

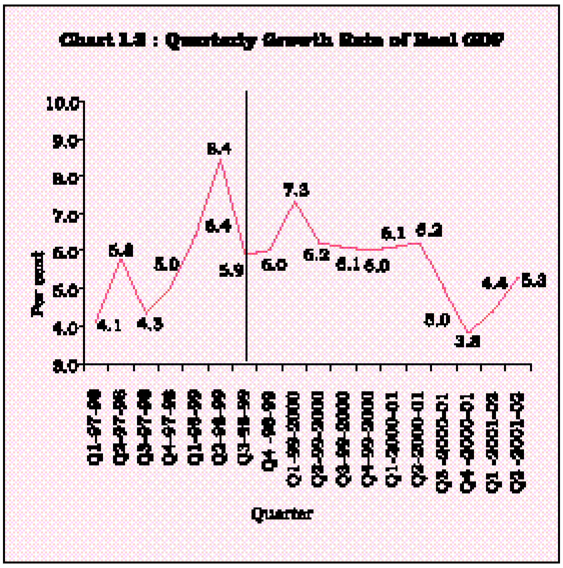
* : As at the end of the period.
\# : On a year-on-year basis
\## : On residual maturity basis.
$: Data pertain to second quarter (July - September) of the respective year.

RE : Revised Estimates
mt : Million tonnes.

Real Sector

1.7 Real GDP growth in the second quarter of 2001-02 at 5.3 per cent was a moderate improvement over 4.4 per cent recorded in the first quarter of 2001-02 and the trough of 3.8 per cent recorded in the last quarter of 2000-01. However, real GDP growth in the second quarter of 2001-02 was lower at 5.3 per cent as compared with 6.2 per cent in the corresponding quarter of 2000-01. This decline in the growth of GDP is attributed to the declines in the growth rates of both industry and services sectors which have offset the improvement in the growth rate of agriculture. The behaviour of quarterly GDP growth suggests that the current deceleration has taken root since the third quarter of 1998-99 (Chart I.3).

1.8 The decline in GDP growth during the second quarter of the current year has been mainly due to the poor performance of 'mining and quarrying', 'manufacturing', 'construction', 'trade, hotels, transport and communication' and 'community, social and personal services'. On the other hand, 'agriculture and allied activities', 'electricity, gas and water supply' and 'financing, insurance, real estate and business services' experienced some acceleration of growth ([Table 1.2](#)).

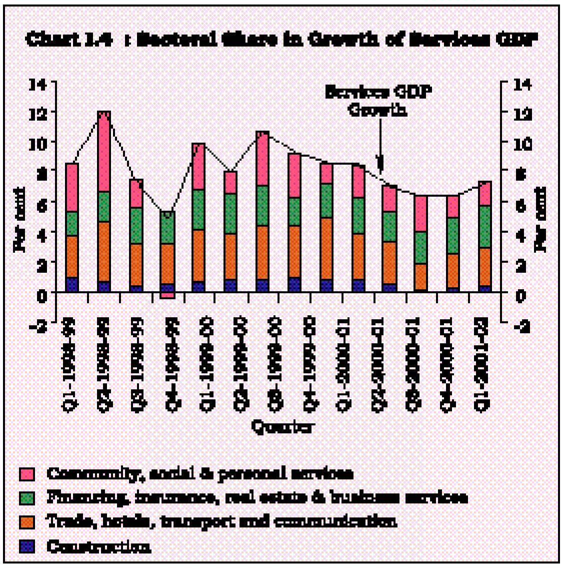


1.9 Intra-sectoral variations in the growth performance of the service sector industries have brought about perceptible shifts in the contribution of each of these industries to the overall output of the services sector (Chart I.4).

Table 1.2 : Quarterly Estimates of GDP@

	Gross Domestic Product (Rs. crore)						Percentage change over previous year			
	1999-2000		2000-01		2001-02		2000-01		2001-02	
	Q1	Q2	Q1	Q2	Q1	Q2	Q1	Q2	Q1	Q2
1	2	3	4	5	6	7	8	9	10	11
1. Agriculture, forestry and fishing	69,715	50,200	70,167	50,428	71,813	52,121	0.6	0.5	2.3	3.4
2. Mining and quarrying	6,162	6,242	6,473	6,481	6,473	6,519	5.0	3.8	0.0	0.6
3. Manufacturing	46,980	47,727	50,248	50,590	51,397	51,770	7.0	6.0	2.3	2.3
4. Electricity, gas and water supply	6,882	7,086	7,271	7,299	7,510	7,650	5.7	3.0	3.3	4.8
5. Construction	14,034	13,864	15,206	15,032	15,584	15,652	8.4	8.4	2.5	4.1
6. Trade, hotels, transport and communication	58,627	58,390	64,293	62,629	67,667	66,522	9.7	7.3	5.2	6.2
7. Financing, insurance, real estate and business services	34,958	35,371	38,270	38,842	42,060	43,124	9.5	9.8		9.911.0
8. Community, social and personal services	33,255	34,726	35,240	37,938	37,437	40,240	6.0	9.3	6.2	6.1
GDP at factor cost	**2,70,613**	**2,53,607**	**2,87,168**	**2,69,241**	**2,99,941**	**2,83,599**	**6.1**	**6.2**	**4.4**	**5.3**

@ : at 1993-94 prices.
Note : Q1: April-June and Q2: July-September.



1.10 There is evidence of increasing co-movement between the variability of real activity in India and the variability of world output indicating that the Indian economy is not completely insulated from the turns and phases of the global business cycle. India's openness to cross-border trade and private capital has increased considerably in the 1990s in response to structural reforms including external financial liberalisation. The impact of globalisation on the economy has been somewhat symmetric with gains accruing from expansion in world activity as well as contraction occurring in tandem with global slowdown (Chart I.5).

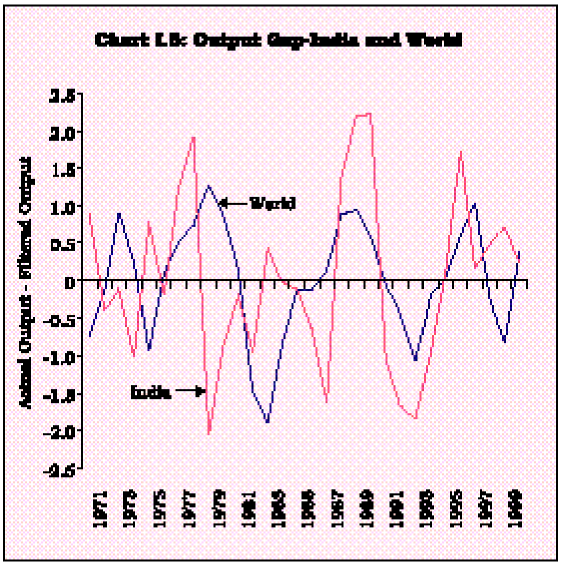


Chart I.5: Output Gap-India and World

Saving and Investment

1.11 The saving and gross capital formation rates were estimated higher at 22.3 per cent and 22.7 per cent in 1999-2000, respectively, as compared to 22.0 per cent and 21.2 per cent, respectively, during 1998-99 (Chart 1.6). The process of consolidation of macro-balances continued during the 1990s. The saving-investment (adjusted for errors and omissions) gap narrowed down from 1.5 per cent in 1997-98 to remain at 1.0 per cent in 1998-99 and 1999-2000. Another underlying development is the deterioration in the rate of public saving-investment deficit without commensurate improvement in the rate of private sector surplus (Chart I.7).

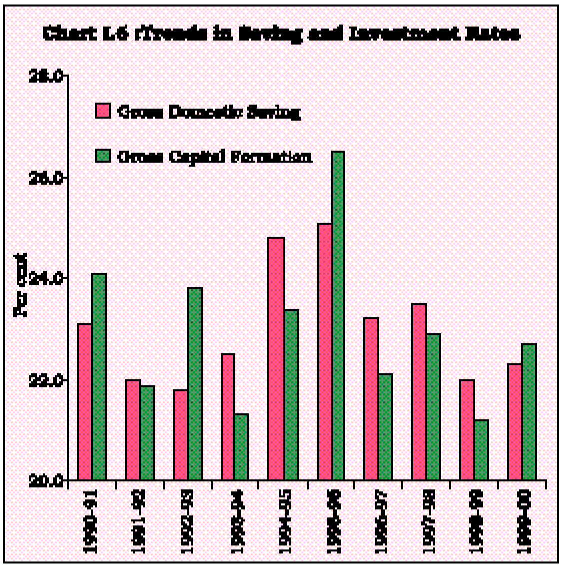


Chart I.6 :Trends in Saving and Investment Rates

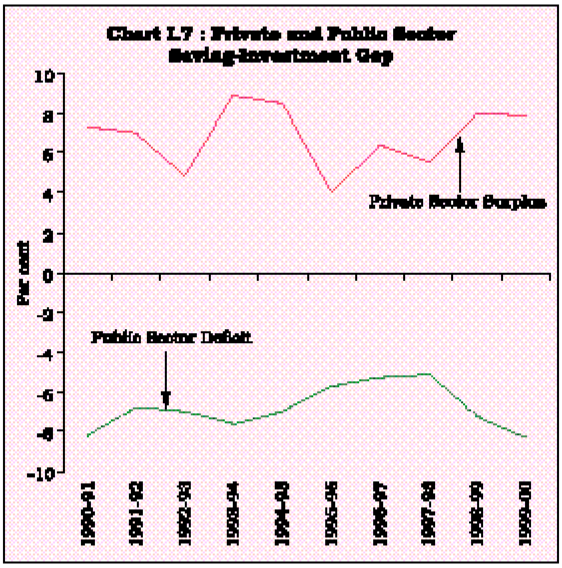


Chart I.7 : Private and Public Sector Saving-Investment Gap

1.12 The household saving, which has a predominant share in domestic saving, has undergone shifts in the pattern of mobilisation with the share of deposits and contractual savings remaining high (Chart I.8). Corporate sector saving has shown a declining trend in the second half of the 1990s. Public sector saving became negative in 1998-99 and has worsened thereafter (Chart I.9).

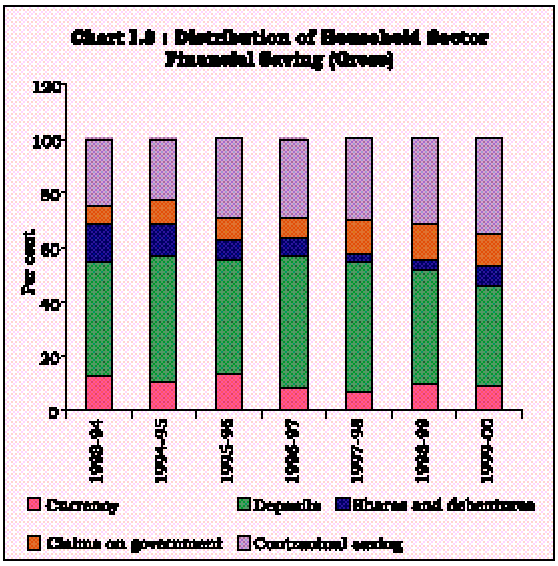
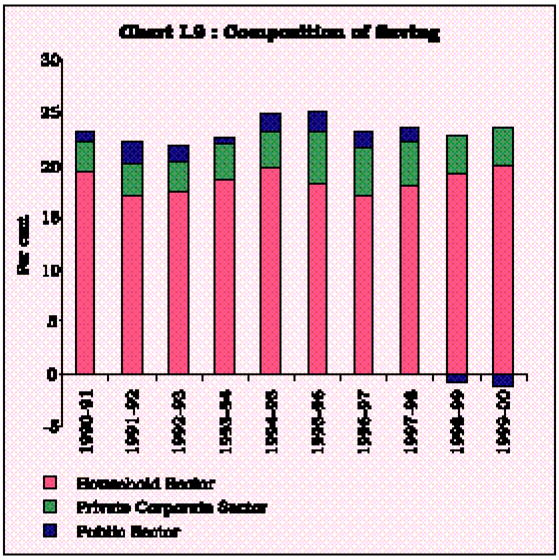
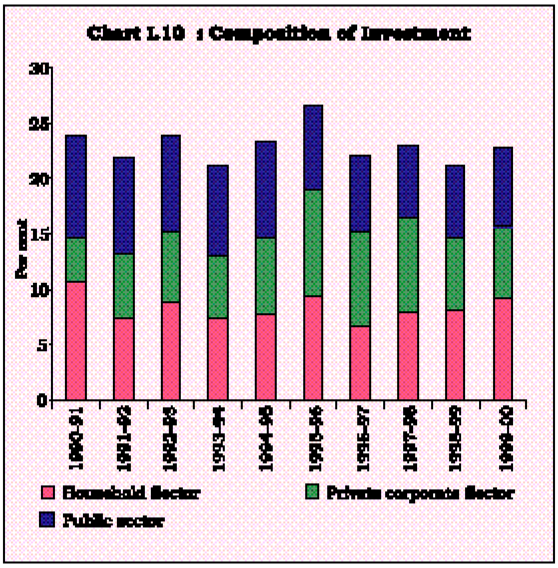


Chart I.8 : Distribution of Household Sector Financial Saving (Gross)



1.13 The investment rate has moved in tandem with the saving rate. All the constituent sectors, except the private corporate sector, recorded increases in the rates of capital formation during 1998-2000 (Chart I.10).



Agriculture

1.14 The GDP growth in 'agriculture and allied activities' improved to 2.3 per cent in the first quarter of 2001-02, as compared with 0.6 per cent in the corresponding quarter of the previous year, reversing the absolute decline which occurred in the last quarter of 2000-01. In the second quarter, the performance of the ‘agriculture and allied activities’ improved further to 3.4 per cent as against 0.5 per cent during the corresponding period of the previous year. In the recent period, there has been some dampening of the variability of GDP growth in agriculture (measured in terms of the deviations from limits set by +/- one standard deviation) although this appears to be associated with the slowing down of growth (Chart I.11).

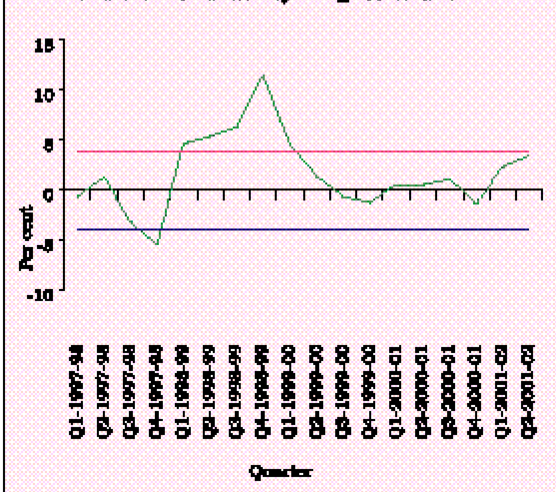


Chart I.11 : Variability in Agricultural GDP

1.15 According to the latest information available from the Union Ministry of Agriculture, the overall *kharif* foodgrain production for 2001-02 was at a record 105.59 million tonnes. Rice production at 76.4 million tonnes was higher by 2.0 million tonnes than in the previous year, while pulses also recorded a rise in production. The increase in rice production is mainly attributable to the favourable distribution of rainfall during South-West monsoon 2001, which resulted in yield gains, despite a reported fall in acreage. This year's South-West monsoon had a precipitation of 90 per cent of the Long Period Average, but was characterised by better spatio-temporal distribution (Chart I.12). Chattisgarh, Gujarat, Madhya Pradesh and Rajasthan received excess/normal rainfall, thus relieving the water scarcity conditions that were experienced in these States in the previous two years. The output of coarse cereals, however, witnessed a marginal decline to 23.9 million tonnes from the previous year's level of 24.0 million tonnes, despite an area increase.

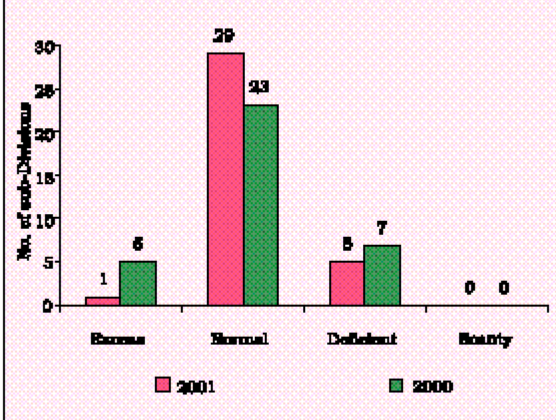
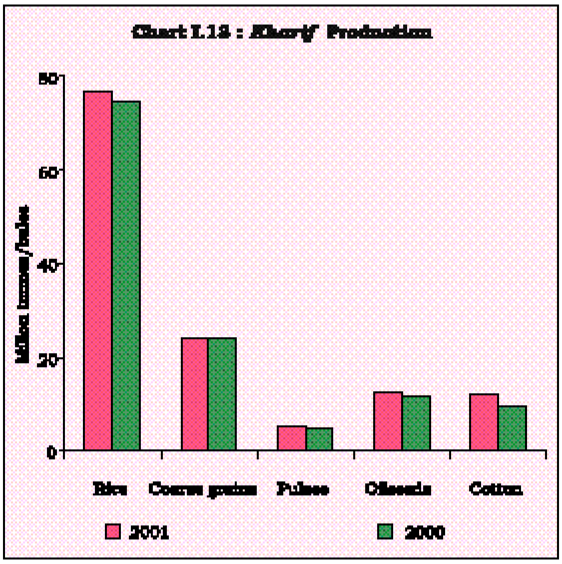


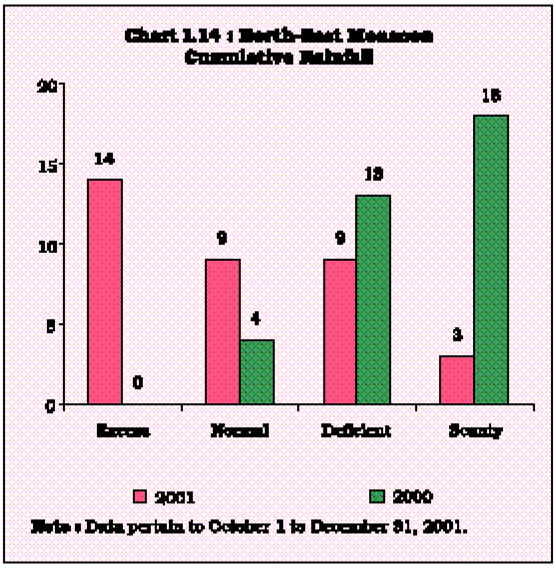
Chart I.12 : South-West Monsoon Cumulative Rainfall

Note: Data pertain to June 1, 2001 to September 30, 2001

The production of *kharif* oilseeds recovered from the poor performance of the previous two years, especially that of groundnut and soyabean, though the output of castorseed and sunflower declined. The improved performance of groundnut and soyabean took the *kharif* oilseeds production in 2001-02 to 12.5 million tonnes from the previous year's level of 11.6 million tonnes. Much of the increased production can be attributed to rise in productivity. Output of cotton at 12.3 million bales is also higher than that in the previous year (Chart I.13). The production of sugarcane at 280.0 million tonnes, however, is less than the previous year's record production of 300.3 million tonnes (Table 1.3).



1.16 The North-East monsoon 2001 has also been satisfactory with 23 sub-divisions receiving excess to normal rainfall, with the number of sub-divisions receiving deficient/ scanty rainfall declining from 31 in 2000 to 12 in the current year (up to December 31, 2001) (Chart I.14). In recent years, consistent increase in wheat production has blurred the compositional distinction between *kharif* and *rabi* foodgrains output, with the latter accounting for around 50 per cent of the total foodgrains production (Chart I.15).



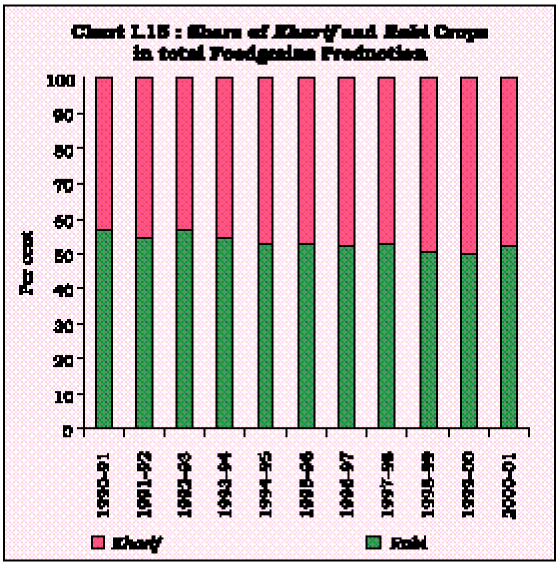


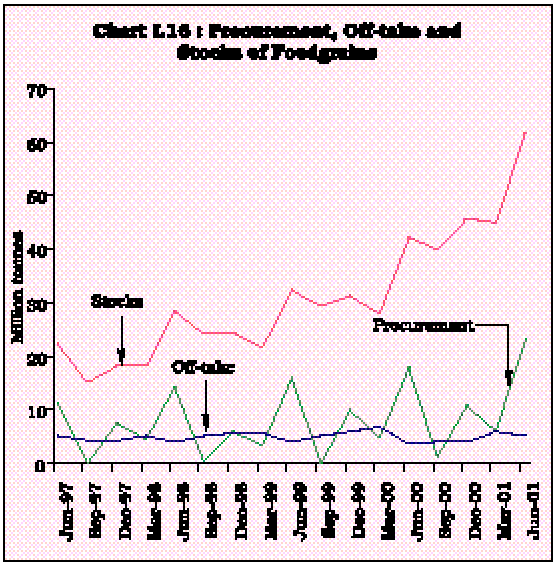
Table 1.3 : Targets and Achievements in Agricultural Production during 2000-01 and 2001-02

(Million Tonnes/Bales)

	2000-2001				2001-2002		
	Kharif		*Rabi*		*Kharif*		*Rabi*
Crop	T	A.E.	T	A.E.	T	A.E.	T
1	2	3	4	5	6	7	8
Rice	76.30	74.41	13.70	11.89	77.98	76.42	14.02
Wheat	—	—	74.00	68.46	—	—	78.00
Coarse grains	26.62	24.02	6.38	6.23	26.12	23.92	6.85
Pulses	6.00	4.68	9.00	6.38	6.00	5.25	9.00
Total Foodgrains	**108.92**	**103.11**	**103.08**	**92.96**	**110.10**	**105.59**	**107.87**
Oilseeds	16.50	11.58	11.50	6.62	16.50	12.54	11.50
Sugarcane	325.00	300.32	—	—	325.00	279.96	—
Cotton*	14.50	9.39	—	—	14.50	12.30	—
Jute and Mesta**	10.00	10.37	—	—	11.00	—	—

T	:	Target.
A.E.	:	Advance Estimates as on September 29, 2001.
*	:	Production in Million Bales of 170 kg. each.
**	:	Production in Million Bales of 180 kg. each.
Source	**:**	Ministry of Agriculture, Government of India.

1.17 During the current financial year up to December 31, 2001, the procurement of rice and wheat rose by 15.0 per cent to 34.8 million tonnes. The total off-take of foodgrains (up to end-November, 2001) increased substantially by 55.6 per cent on account of a sharp rise in the off-take under open market sales (OMS) and other welfare scheme (OWS). Off-take under Targeted Public Distribution System (TPDS) also increased by 6.0 per cent to 8.4 million tonnes from 7.9 million tonnes in the corresponding period of the previous year. With the substantial rise in procurement levels, the stocks of foodgrains rose to 59.1 million tonnes at the end of November 2001, indicating a rise of 30.0 per cent over the level in November 2000 (Chart I.16).



Industry

1.18 Real GDP growth originating from industry continues to be in the downturn phase which began from the first quarter of 2000-01. There was, however, a marginal improvement, with real GDP growth from industry increasing to 2.4 per cent in the second quarter of 2001-02 from 2.2 per cent in the first quarter. The industrial slowdown is concentrated in the mining and quarrying and manufacturing sectors which have experienced a continuous erosion in their contribution to overall industrial growth (Chart I.17).

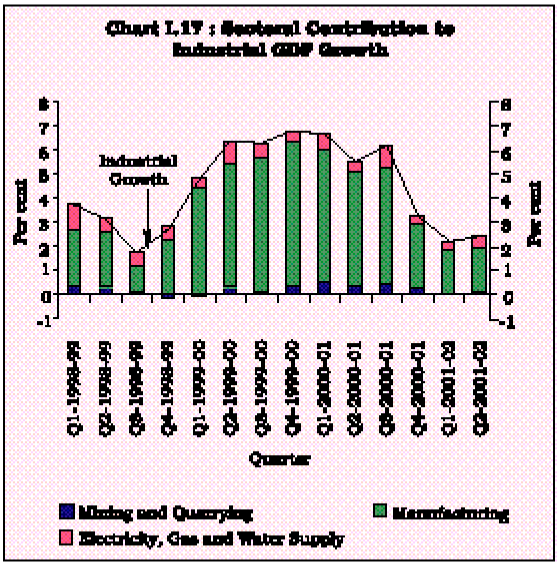


Chart I.17 : Sectoral Contribution to Industrial GDP Growth

1.19 The index of industrial production (IIP), however, recorded a growth of 2.2 per cent during April-October 2001 as against 5.9 per cent during April-October 2000 ([Table 1.4](#)). The monthly growth of the IIP has remained lower in all the months of the current year as compared with the corresponding months of 2000-01 (Chart I.18).

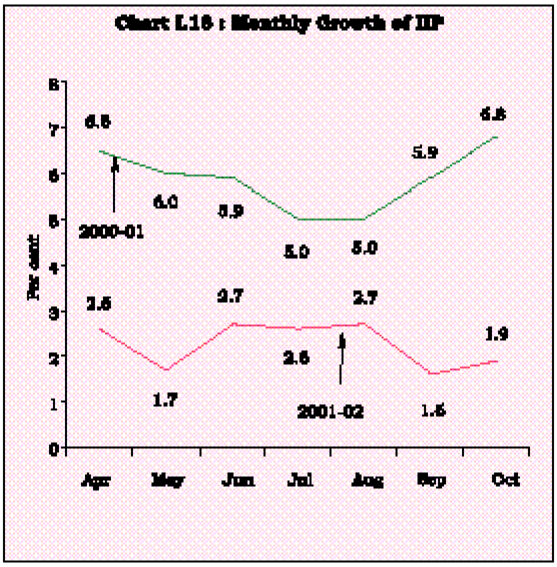


Chart I.18 : Monthly Growth of IIP

Table 1.4 : Sector-wise Monthly Growth of IIP

(Per cent)

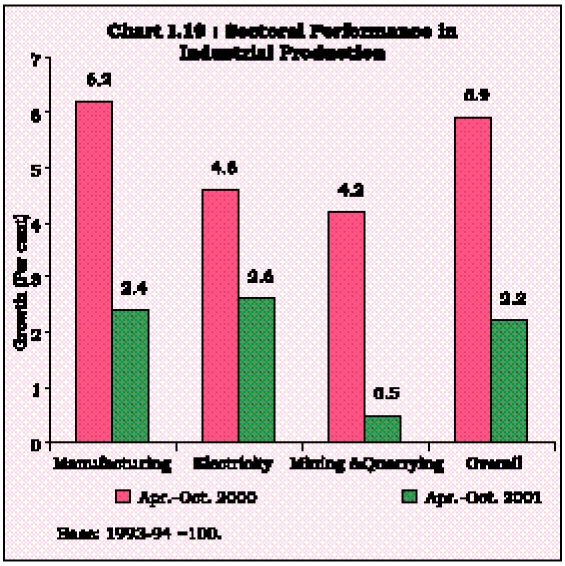
Month	General (100.00)		Electricity (10.17)		Mining and Quarrying (10.47)		Manufacturing (79.36)	
	2000-01	2001-02	2000-01	2001-02	2000-01	2001-02	2000-01	2001-02
1	2	3	4	5	6	7	8	9
April	6.5	2.6	3.7	1.5	4.0	3.4	7.1	2.7
May	6.0	1.7	6.4	3.0	2.6	-0.5	6.2	1.8
June	5.9	2.7	5.0	2.1	4.4	-3.7	6.1	3.4

July	5.0	2.6	2.6	4.7	2.0	-2.0	5.7	2.9
August	5.0	2.7	1.0	2.7	4.0	-0.1	5.5	3.0
September	5.9	1.6	2.2	4.6	5.4	4.0	6.4	1.0
October	6.8	1.9	11.5	-0.6	6.6	2.4	6.2	2.2
April-October	**5.9**	**2.2**	**4.6**	**2.6**	**4.2**	**0.5**	**6.2**	**2.4**

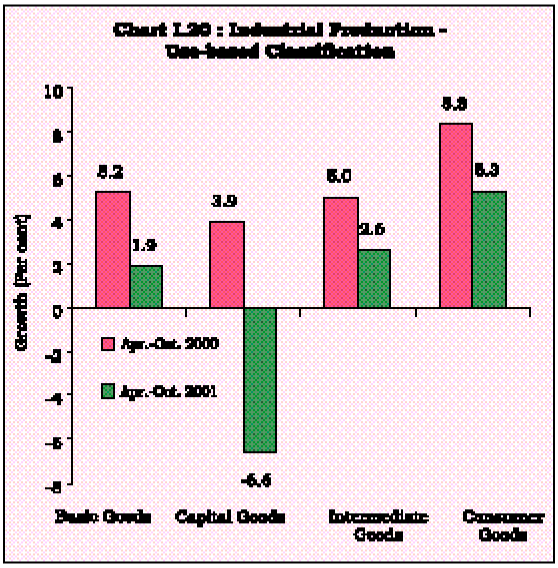
Note : 1.Data for 2001-02 are provisional.
2.Figures in brackets are weights in IIP.

Source: Central Statistical Organisation (CSO).

1.20 Manufacturing sector growth slowed down to 2.4 per cent from 6.2 per cent in April-October 2000. Electricity generation also decelerated to 2.6 per cent as against 4.6 per cent in the previous year, while the mining sector recorded a low growth of 0.5 per cent as compared with a growth of 4.2 per cent during April-October 2000 (Chart I.19).



1.21 On a cumulative basis, all the sectors of industry showed either deceleration or decline. The basic goods, intermediate goods and consumer goods sectors recorded lower growth of 1.9 per cent, 2.6 per cent and 5.3 per cent, respectively, during April-October 2001 as compared with 5.2 per cent, 5.0 per cent and 8.3 per cent, respectively, during April-October 2000. The capital goods sector registered an absolute decline of 6.6 per cent during April-October 2001 as against a positive growth of 3.9 per cent during the corresponding period of the previous year (Chart I.20).



1.22 Within manufacturing, eleven out of seventeen 'two-digit' industry groups recorded positive growth during April-October 2001. Out of the seventeen 'two-digit' industry groups, seven groups (25.9 per cent weight in IIP) registered accelerated growth and four groups (30.2 per cent weight in IIP) recorded decelerated growth as compared to eight groups in the previous year. The remaining six groups (23.2 per cent weight in IIP) registered a decline as against two groups in the previous year. Out of seven groups which experienced accelerated growth, 'leather and leather and fur products' (15.6 per cent), 'rubber, plastic, petroleum and coal products' (12.0 per cent), and 'beverages, tobacco and related products' (10.5 per cent) recorded the highest growth. On the other hand, 'food products' , 'cotton textiles', 'textile products (including wearing apparel)', 'jute and other vegetable fibre textiles (except cotton)', 'wood and wood products, furniture and fixtures', and 'metal products and parts (except machinery and equipment)' recorded a decline (Table 1.5).

Table 1.5 : Classification of Groups of Manufacturing Industries by Growth Performance

Classification	April-October 2000-01 No. of Industry Groups	April-October 2000-01 Weight in IIP	April-October 2001-02 No. of Industry Groups	April-October 2001-02 Weight in IIP
1	2	3	4	5
Acceleration	7	26.0	7	25.9
Deceleration	8	46.7	4	30.2
Negative	2	6.6	6	23.2
Manufacturing (Total)	**17**	**79.4**	**17**	**79.4**

Source: Central Statistical Organisation.

1.23 Although the capital goods sector has a relatively low weight (9.26 per cent) in the overall

IIP, it has crucial importance as a leading sector with substantial forward linkages. Capital goods production has implications for the growth of productive capacity and future prospects of industrial growth. The production of capital goods has declined in all months during April-October 2001, although imports of capital goods showed some signs of revival during the months of July and August 2001, however, it declined again during September 2001 (Chart I.21).

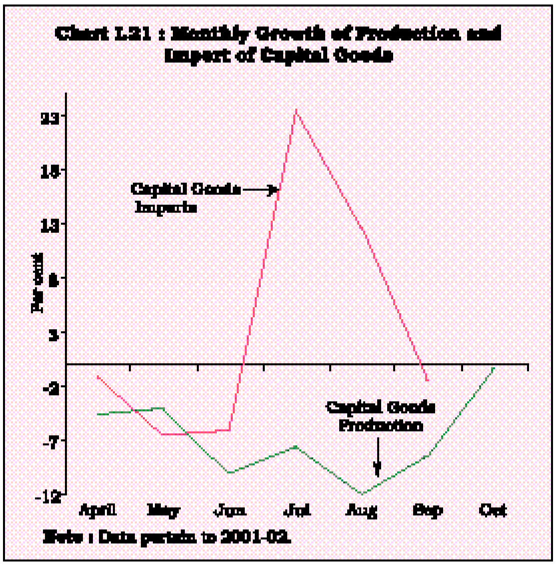
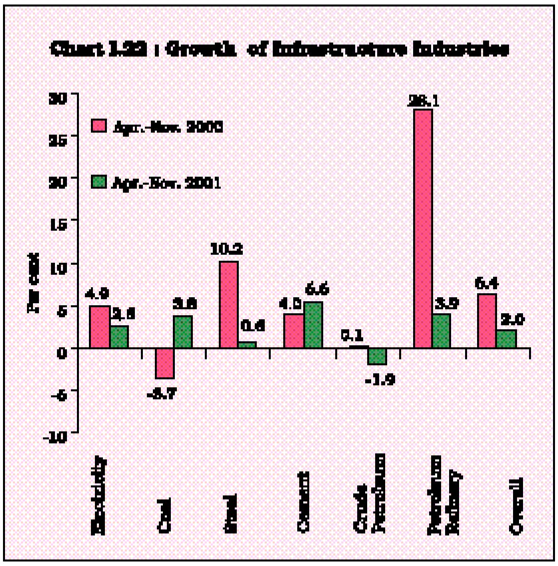


Chart I.21 : Monthly Growth of Production and Import of Capital Goods

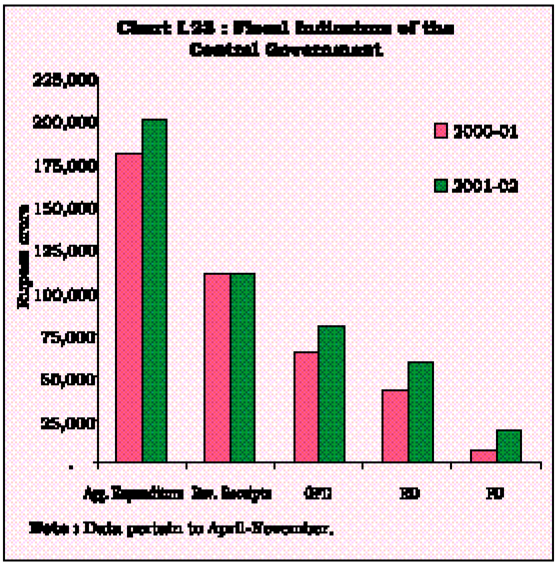
1.24 During April-November 2001, the overall growth of infrastructure industries was substantially lower at 2.0 per cent as compared with a growth of 6.4 per cent during April-November 2000. Petroleum refinery products registered a substantially lower growth of 3.9 per cent as against 28.1 per cent in the previous year. Production in the electricity and steel sectors also recorded lower growth of 2.6 per cent and 0.6 per cent, respectively, during April-November 2001 as against 4.9 per cent and 10.2 per cent, respectively, in the previous year. Production of crude petroleum recorded a decline of 1.9 per cent during April-November 2001 as against a growth of 0.1 per cent during April-November 2000. Coal sector has shown a positive growth of 3.8 per cent as against a negative growth of 3.7 per cent during April-November 2000 (Chart I.22).



1.25 The overall investment climate remained depressed during April-October 2001 as reflected in a sharp decline in resource mobilisation from new issues and private placement and deceleration in sanctions and disbursements of financial assistance by financial institutions and non-food credit off-take from commercial banks. The decline in agricultural production in the previous two years, deceleration in power generation, persistence of inventory accumulation in some industries, slowdown in infrastructure and the overall pessimism in the investment climate are the factors which would weigh heavily on the industrial outlook for 2001-02.

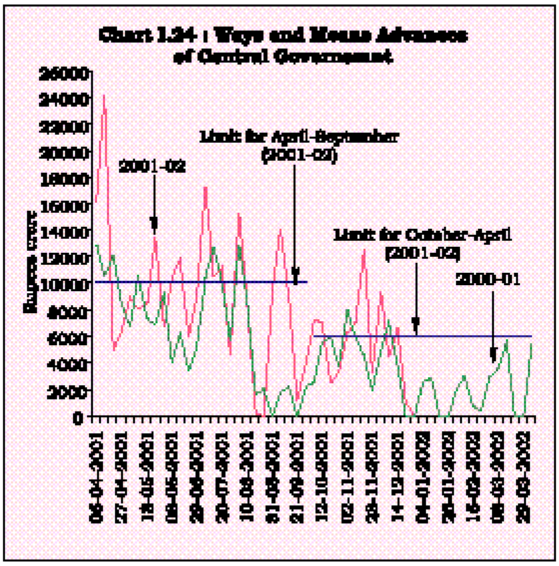
Public Finances

1.26 The budgetary position of the Central Government has undergone some deterioration during the first eight months of current fiscal year (April-November 2001) mainly due to decline in tax collection and steady rise in expenditure over the levels in the same period of 2000-01 (Chart I.23). The gross fiscal deficit (GFD) at Rs.79,133 crore was higher by 23.1 per cent over April-November 2000 (Rs.64,269 crore) and constituted 68.0 per cent of the budget estimates (Rs.1,16,314 crore) for 2001-02. The revenue deficit at Rs.59,270 crore (75.2 per cent of budget estimates) was higher by 38.9 per cent over the level in the same period of the previous year (Rs.42,662 crore). The primary deficit, at Rs.19,333 crore, during April-November 2001 more than doubled over that in April-November 2000 (Rs.7,188 crore).

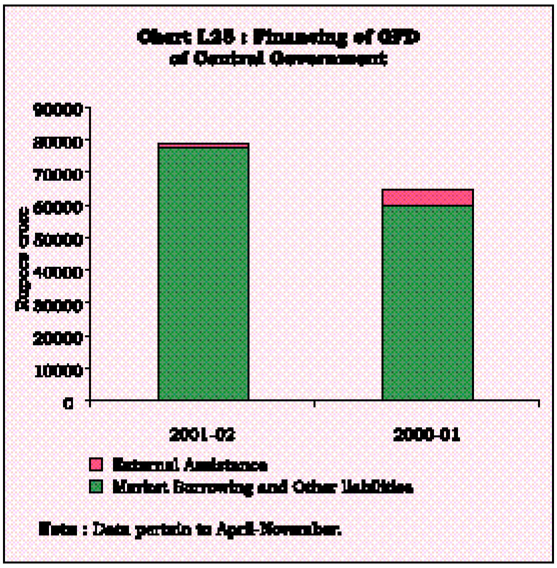


1.27 Revenue receipts during April-November 2001 increased by 0.5 per cent (as against 16.1 per cent growth in April-November 2000) and disinvestment collection was at Rs.206 crore during April-November 2001. The aggregate expenditure was higher by 10.9 per cent over April-November 2000 (8.8 per cent). The monthly trends indicate some easing of pressure on Central finances since August 2001 following improvement in revenues. Nevertheless, these developments indicate some pressure in meeting the targeted levels for important fiscal variables in the Union Budget 2001-02 such as gross fiscal deficit (GFD) at 4.7 per cent of GDP, the revenue deficit at 3.2 per cent of GDP, the primary deficit at 0.2 per cent of GDP, increase in aggregate expenditure at 11.8 per cent, revenue expansion at 12.4 per cent and mobilisation through disinvestment at Rs.12,000 crore.

1.28 The Centre's Ways and Means Advances (WMA) for the first and second halves of 2001-02 were fixed at Rs.10,000 crore (April-September) and Rs.6,000 crore (October-March), respectively. During the first half of 2001-02, the average of the fortnightly utilisation of WMA (inclusive of overdrafts) was Rs.8,138 crore, higher than in the same period of the previous year (Rs.7,024 crore). The outstanding WMA as on December 28, 2001 was nil (Chart I.24).



1.29 The gross market borrowings of the Centre for the fiscal year 2001-02 are budgeted at Rs.1,18,852 crore and net borrowings at Rs.77,353 crore. The net market borrowings are budgeted to finance 66.5 per cent of the gross fiscal deficit of the Central Government during 2001-02. During the current fiscal year so far (up to December 28, 2001), the Central Government has raised gross borrowings of Rs.1,16,002 crore and net market borrowings of Rs.79,002 crore. The Reserve Bank continued to combine auction issues with acceptance by private placement of dated securities of the Government in tune with market conditions. Devolvement/private placement with the Reserve Bank amounted to Rs.25,679 crore up to December 28, 2001. Market borrowings continued to form the dominant source of financing of the Centre's GFD (Chart I.25).



1.30 The interest rates on market borrowings have shown a persistent decline during the year so far. For instance, the interest rate on primary issue of government securities with a 10-year residual maturity declined from 10.25 per cent on April 12, 2001 to 9.22 per cent on July 25, 2001, and the yield on 15-year bonds declined from 10.71 per cent on April 18, 2001 to 8.1 per cent on December 5, 2001. Similarly, the yield on 25-year bond declined from 10.18 per cent on September 10, 2001 to 8.95 per cent on November 19, 2001. At the shorter maturity range, the yield on 364-day Treasury Bills declined from 8.85 per cent on April 4, 2001 to 7.10 per cent on September 5, 2001 and further to 6.68 per cent as on November 28, 2001. Similarly, the yield on 91-day Treasury Bills has declined from 8.50 per cent on April 4, 2001 to 6.63 per cent on October 24, 2001 and further to 6.50 per cent on November 28, 2001. However, cut-off yields on 91-day and 364-day Treasury Bills were at 7.25 per cent and 7.38 per cent, respectively, as on December 26, 2001.

1.31 The finances of State Governments during 2001-02 are budgeted to improve over the revised estimates for 2000-01 in terms of revenue deficit, gross fiscal deficit and primary deficit (from 2.3 per cent, 4.4 per cent and 1.9 per cent, respectively in 2000-01 to 1.9 per cent, 3.9 per cent and 1.2 per cent of GDP, respectively in 2001-02). The revenue receipts are budgeted to be higher by 14.2 per cent with States' own revenue receipts (tax revenue and non-tax revenue) expected to finance 53.0 per cent of the revenue expenditure and 43.9 per cent of the aggregate expenditure in 2001-02, as compared with 50.0 per cent and 41.1 per cent, respectively, in 2000-01 (RE). On the expenditure front, revenue expenditure continues to absorb a major portion of receipts. The growth in revenue expenditure is mainly due to non-developmental expenditure which is estimated to show a higher growth of 18.0 per cent as against 15.2 per cent in the previous year. The growth rate in developmental expenditure is estimated to sharply decelerate from 15.3 per cent in 2000-01 to 5.4 per cent in 2001-02. The share of social and economic services in aggregate expenditure is estimated to decline to 58.4 per cent in the budget estimates for 2001-02 from 61.2 per cent in the previous year. A noteworthy development is the focus on the need for increased budgetary allocation for natural calamities, which rose to Rs.8,185 crore in 2001-02 as compared with Rs.5,001 crore in the revised estimates for 2000-01.

1.32 The continued emphasis on fiscal reforms at sub-national level has gained significance and become an important component of overall economic restructuring. The State Budgets for 2001-02 proposed measures reflecting the urgency to expedite the fiscal consolidation process, while focusing on infrastructure development and growth enhancing sectoral policies. The measures taken by the States include setting up of Consolidated Sinking Fund, Expenditure Review/Reform Committee, Guarantee Redemption Funds, Infrastructure Development Funds and Tax Reforms Commissions, placing statutory limits on guarantees, restructuring the public sector undertakings (PSUs) and comprehensive rationalisation of posts. The medium-term fiscal plan drawn up by some of the State Governments provide a time-frame for implementing fiscal reforms to achieve fiscal soundness. States have also focused on development of infrastructure including encouragement to private investment in the infrastructure projects and promotion of growth enhancing sectors like information technology, horticulture, agro-based industries, *etc.*

1.33 The information on the fiscal outturn of the State Governments during the current year so far is not available. However, the recourse to WMA from the Reserve Bank in the current fiscal year 2001-02 so far (up to December 21, 2001) generally remained higher than that in the previous year and reveals some pressure on State finances. The outstanding WMA and overdrafts from the Reserve Bank as on December 21, 2001 amounted to Rs. 6,720 crore as against Rs.4,305 crore as on December 22, 2000 (Chart I.26).

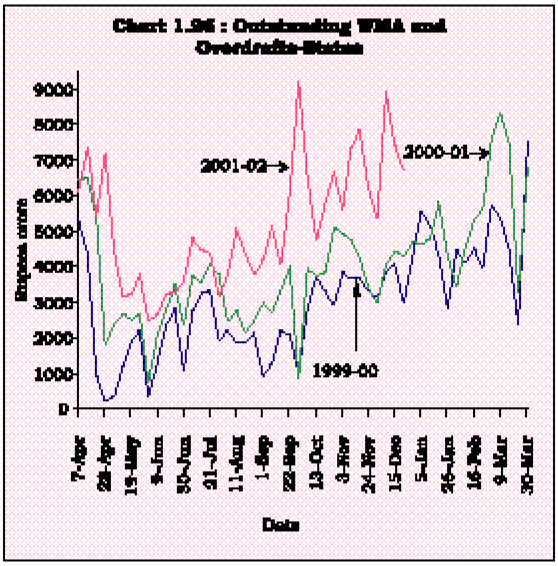


Chart 1.96 : Outstanding WMA and Overdrafts-States

1.34 For the fiscal year 2001-02, States were allocated gross and net market borrowings of Rs.14,304 crore and Rs.12,857 crore, respectively. The State Governments have raised an amount of Rs.11,849 crore, constituting 82.84 per cent of the gross market borrowings programme for the full fiscal year (up to December 28, 2001). The amount was raised through pre-announced issues (including taps) as well as through auctions. The interest rate varied in the range of 8.37 per cent to 10.53 per cent in 2001-02 (up to December 28, 2001) as against 10.50 per cent to 12.00 per cent in the previous year (2000-01).

Monetary Developments

1.35 In April 2001, the monetary and credit policy for 2001-02 was announced against the background of comfortable liquidity conditions and orderly financial markets. In pursuance of the monetary stance of ensuring adequate credit consistent with price stability, the Reserve Bank undertook to continue its policy of active management of liquidity through the liquidity adjustment facility (LAF) supported by strategic open market operations (OMO) and further reductions in the cash reserve ratio (CRR) if warranted. The Reserve Bank also indicated its policy intention of maintaining the current interest rate environment with a preference for softening over the medium-term unless underlying conditions changed dramatically. In April 2001, monetary policy was framed in the context of a real GDP growth forecast at 6-6.5 per cent under the assumptions of an industrial recovery from the second quarter of 2001-02, a reasonable monsoon, and a good performance of exports. Inflation was placed within 5 per cent. Indicative projections for M3 at 14.5 per cent and commercial banks' non-food credit adjusted for non-SLR investments at 16-17 per cent were made consistent with the macroeconomic forecasts. The LAF, which has emerged as an effective and flexible instrument for influencing liquidity on a day-to-day basis, moved into its second stage in May 2001. Variable rate repos replaced the collateralised lending facility and Level I support to primary dealers (PDs). Standing refinance facilities were rationalised and a back-stop facility was introduced at market-related rates of interest. LAF operating procedures were recast to improve operational flexibility. In the first graduated move towards enabling the call money market to evolve into a pure inter-bank market, lending by non-banks was reduced to 85 per cent of their average daily lendings in the call money market in 2000-01 from May 5, 2001. Other measures such as shortening of the minimum maturity of wholesale deposits from 15 days to 7 days, revision in the daily minimum maintenance of CRR to 50 per cent for the first seven days of the reporting fortnight and 65 per cent for the next seven days and exemption of inter-bank term liabilities from the minimum CRR of 3 per cent on net demand and time liabilities were undertaken to improve the functioning of the money market and thereby, the transmission of monetary policy.

1.36 The mid-term review of the monetary and credit policy in October 2001 took into account the unfavourable performance of the industrial sector relative to initial expectations, the sluggishness in infrastructure industries, the decline in exports amidst a heightening of global uncertainty, and the slack in the off-take of non-food credit to revise the growth forecast for the year to 5-6 per cent. The announced stance of monetary policy was persevered with - to continue active liquidity management with strategic combinations of instruments. In keeping with the indicated preference for a softer interest rate environment, the Bank Rate was reduced by 50 basis points to 6.5 per cent and the CRR by 200 basis points. However, all the exemptions on the liabilities, except inter-bank liabilities, were withdrawn for the computation of net demand and time liabilities for the purpose of CRR. These measures are expected to contribute to money market development and to the conduct of monetary policy, besides the overarching objective of creating conditions for a revival of growth with low inflation. Financial sector reforms were carried forward and the development of the money and government securities segments of the financial market gathered momentum. The projections for monetary and credit growth remained unchanged.

1.37 Reserve money expansion (up to December 28, 2001) was of the order of 3.7 per cent as against 1.7 per cent during the corresponding period of last year, primarily driven by the steady accretion to the Reserve Bank's foreign currency assets (net of revaluation) which rose by Rs. 26,217 crore during 2001-02 so far as against Rs. 12,900 crore last year. Currency in circulation expanded by 9.6 per cent as against 8.1 per cent last year. The ratio of net foreign assets (NFA) to currency, a leading indicator of the impact of the balance of payments on the domestic economy, has steadily improved during the year to reach 97.1 per cent as on December 28, 2001 (Chart I.27).

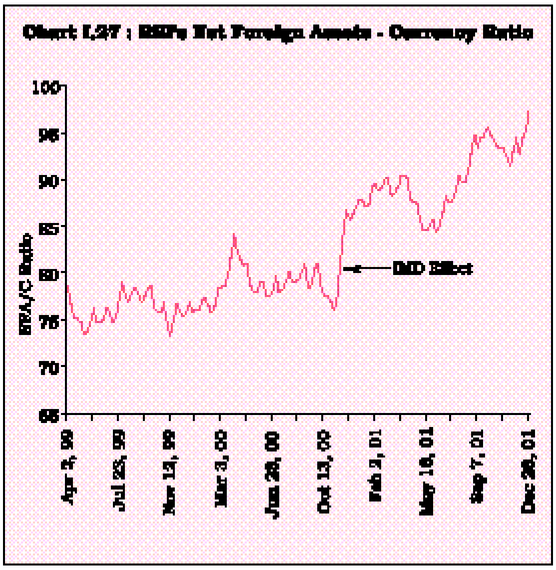


Chart I.27 : RBI's Net Foreign Assets - Currency Ratio

1.38 The net domestic assets (NDA) (adjusted for revaluation) of the Reserve Bank (upto December 28, 2001) underwent a compensating decline of Rs.15,141 crore on top of a decline of Rs.8,036 crore last year (Chart I.28). The net Reserve Bank credit to the Central Government declined by 3.7 per cent as against an increase of 2.2 per cent during the corresponding period of 2000-01. The Reserve Bank's subscription to the Centre's fresh dated securities at Rs.25,679 crore (at face value), was more than offset by net open market sales which amounted to Rs.30,187 crore. Recourse to refinance by commercial banks increased by Rs. 1,944 crore while that by PDs declined by Rs.1,814 crore.

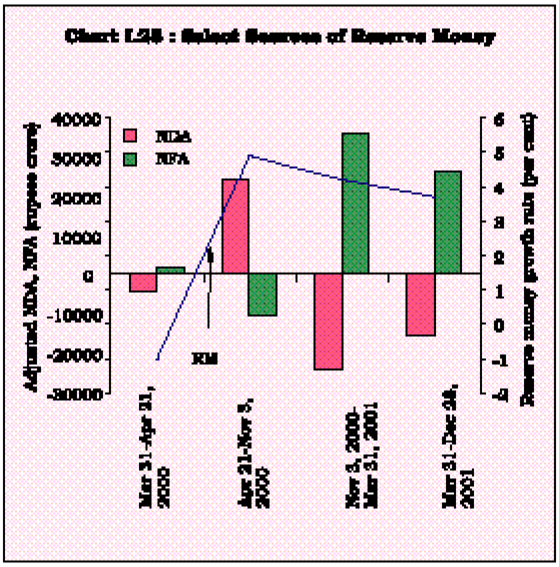
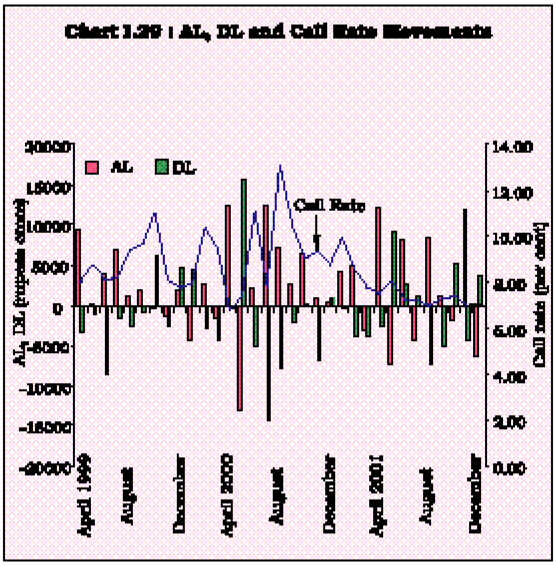


Chart I.28 : Select Sources of Reserve Money

1.39 Since 1999-2000, *i.e.*, with the introduction of the LAF as an interim facility, the Reserve Bank has been modulating market liquidity by strategically counterbalancing autonomous liquidity (AL)[1] with discretionary liquidity (DL) in order to ensure stability in the money market conditions (Chart I.29).



1.40 The progressive movement towards indirect instruments of monetary policy in India has impacted upon the behaviour of reserve money, as policy impulses embodied in changes in the Reserve Bank's balance sheet are being transmitted through the market to the balance sheets of commercial banks. Accordingly, the movements in selected elements of reserve money are increasingly reflecting the Reserve Bank's market operations (Table 1.6).

Table 1.6 : Net Reserve Bank Credit to the Centre

(Rupees crore)

Variable	June 30,2000 Over March 31, 2000	September 22, 2000 Over June 30, 2000	December 29, 2000 Over September 22, 2000	March 31, 2001 Over December 29, 2000	June 29, 2001 Over March 31, 2001	September 21, 2001 Over June 29, 2001	December 28, 2001 Over September 21, 2001
1	2	3	4	5	6	7	8
Net Reserve Bank Credit to the Centre (1+2+3+4-5)	**14,393 (10.3)**	**-6,225 (-4.0)**	**-5,127 (-3.5)**	**3,664 (2.6)**	**19,523 (13.3)**	**-20,140 (-12.1)**	**-4,770 (-3.3)**
1 Loans and Advances	4,316	-5,298	0	5,395	3,619	-7,791	-1,223
2 Treasury Bills held by the Reserve Bank	5	2,001	-2,375	-1,019	-3	-480	0
3 Reserve Bank's Holdings of Dated Securities	7,936	-2,985	-2,593	1,944	13,150	-11,907	-3,529
3.1 Central Government Securities	7,700	-2,985	-2,593	1,944	13,150	-11,907	-4,327
4 Reserve Bank's Holdings of Rupee Coins	13	58	-159	63	39	38	-18
5 Central Government Deposits	-2,123	0	0	2,719	-2,718	0	-1
*Memo Items**							
1 Market Borrowings of Dated Securities by the Centre #	33,683	30,500	26,000	10,000	46,000	31,000	24,000
2 Reserve Bank's Primary Subscription to Dated Securities	6,961	22,815	1,374	0	21,000	679	4,000
3 Repos (-) / Reverse Repos (+) (LAF), net position	0	-10,570	11,130	-1,915	1,355	1,410	-1,160

4 Net Open Market Sales #	1,528	4,259	13,304	128	10,929	13,985	5,273
5 Primary Operations	13,412	17,575	1,215	2,739	27,376	-7,074	2,759

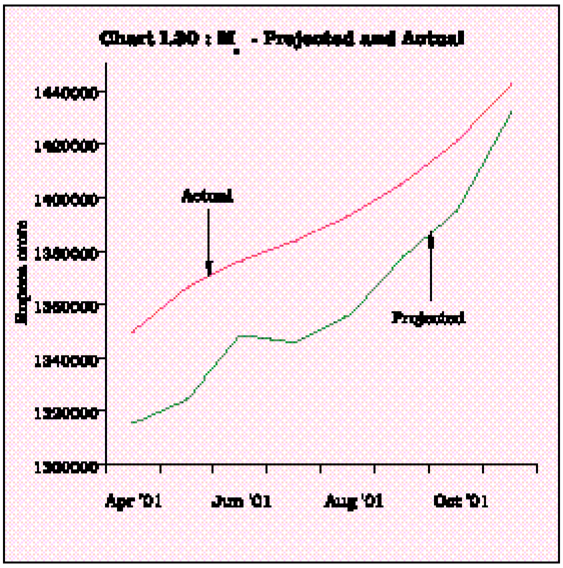
* : At face value.
\# : Excludes Treasury Bills.
Parenthetic figures constitute percentage variations.

Table 1.7 : Monetary Indicators

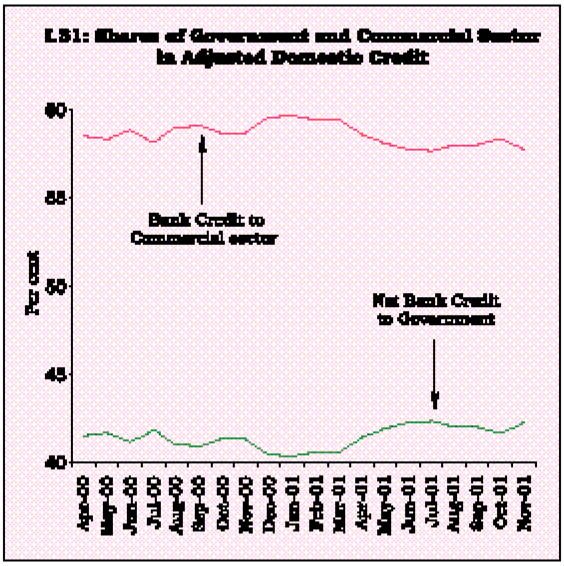
Indicator	2000-01		2001-02 (up to December 14)		2000-01 (up to December 15)	
	Point to Point (Per cent)	Monthly Average Basis (Per cent)	Absolute (Rupees Crore)	Per cent	Absolute (Rupees Crore)	Per cent
1	2	3	4	5	6	7
Reserve Money *	8.1	7.8	11,076	3.7	4,864	1.7
Broad Money (M_3)	16.7 (14.4)	15.8	1,35,921	10.4	1,34,729	12.0 (9.7)
Currency with the Public	10.8	9.2	24,245	11.6	18,197	9.6
Aggregate Deposits	17.8	17.3	1,12,227	10.2	1,17,158	12.6
Net Bank Credit to Government	16.1	13.8	66,579	13.0	57,644	13.1
Bank Credit to Commercial Sector	14.8	20.0	38,674	5.7	52,875	9.0
Net Foreign Exchange Assets of the Banking Sector	21.5	17.9	31,816	12.7	26,870	13.1

* Up to December 28, 2001 and the corresponding period of the previous year. Data are provisional.
Parenthetic figures are net of IMDs.

1.41 Broad money (M_3) increased by 10.4 per cent during the current fiscal year so far (up to December 14) as against 12.0 per cent (9.7 per cent, net of IMDs) during the comparable period of 2000-01 (Table 1.7). Aggregate deposits increased by 10.2 per cent during the year so far from 12.6 per cent (9.8 per cent net of IMDs) last year. On an annual basis, the rate of growth was 15.0 per cent as on December 14, 2001 in M_3 as against 17.1 per cent (14.7 per cent net of IMDs) last year, broadly in alignment with the indicative projections set out in the monetary and credit policy statement for 2001-02 (net (Chart I.30). The average year-on-year M_3 of RIBs/IMDs) growth rate decelerated to 15.1 per cent as on December 14, 2001 from 15.8 per cent as on December 15, 2000.



1.42 Domestic credit (inclusive of commercial banks' non-SLR investments) decelerated to 8.7 per cent during the current fiscal year (up to December 14, 2001) from 10.7 per cent during the corresponding period of the previous year largely on account of lower non-food credit off-take. Net bank credit to the Government, during this period, increased by 13.0 per cent –comparable to 13.1 per cent during the corresponding period of the previous year. Bank credit to the commercial sector decelerated to 5.7 per cent from 9.0 per cent during the comparative period of 2000-01. In the absence of any noticeable pick-up in the demand for bank credit by the commercial sector in the first half of the year, banks predominantly invested in Government paper and accordingly, the share of net bank credit to Government was consistently around 42.0 per cent of adjusted domestic credit (Chart I.31).



1.43 An analysis of the behaviour of the commercial banking indicators during the year 2001-02 (up to December 14) based on the fortnightly returns received from scheduled commercial banks under Section 42(2) of the Reserve Bank of India Act, 1934 brings to the fore several developments which assume relevance in the context of the current deceleration. First, time deposit growth at 12.2 per cent was somewhat higher than the level of the preceding year (11.7 per cent excluding IMDs) despite the decline in interest rates across the spectrum. This could be reflecting safe haven effects in the face of the general uncertainty prevailing in other segments of the financial market. The average fortnightly increase in time deposits works out substantially higher at Rs.5,267 crore during 2001-02 so far, as against Rs.4,216 crore (excluding IMDs) recorded during 2000-01 (up to December 15). Secondly, the average fortnightly increase in non-food credit, on the other hand, was much lower at Rs.1,341 crore than Rs.2,019 crore last year. The growth in non-food credit (adjusted to include the non-SLR investments), at 5.4 per cent during the current financial year was also lower than 9.3 per cent recorded in 2000-01 (up to December 15). Food credit, during this year, showed a lower growth of 29.4 per cent than 43.8 per cent recorded during the corresponding period of 2000-01. The strong deposit accretion without a commensurate credit off-take has resulted in a build up of substantial liquidity with the banks. Thirdly, the investment in government securities was higher at 17.4 per cent during 2001-02 so far as against 16.8 per cent during 2000-01 (up to December 15) (Table 1.8).

1.44 On an annualised basis, aggregate deposits of scheduled commercial banks showed a steady accretion of 15.3 per cent – comparable to 15.2 per cent (net of IMDs) last year. Non-food credit growth, adjusted for non-SLR investments of scheduled commercial banks, as on December 14, 2001, was lower at 11.8 per cent, as against 18.7 per cent as on December 15, 2000. Scheduled commercial banks' investments in government securities accelerated to 22.8 per cent as on December 14, 2001 from 20.5 per cent as on December 15, 2000. Commercial banks' holding of government securities during the year so far has consistently been around 35.0 per cent of the net demand and time liabilities (NDTL) - much higher than the prescribed Statutory Liquidity Ratio (SLR). The inflow of the excess liquid funds of the commercial banks into the government securities market contributed to reducing the secondary market yields of Government securities over the spectrum (Chart I.32).

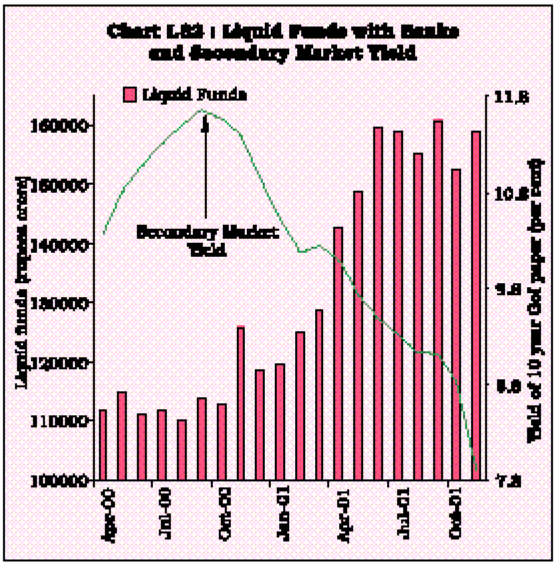


Table 1.8 : Select Banking Indicators : Financial Year Variations

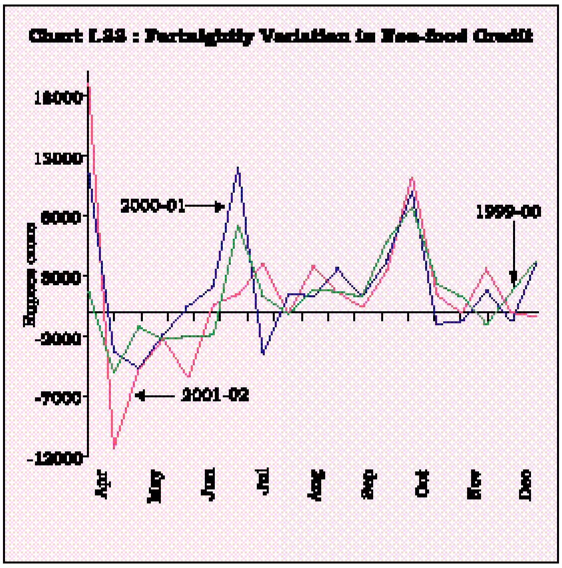
(Rupees Crore)

Indicator	2000-01	1999-2000	2001-02P	2000-01

					(up to mid-December)		(up to mid-December)	
	Absolute	Per cent	Absolute	Per cent	Absolute	Per cent	Absolute	Per cent
1	2	3	4	5	6	7	8	9
Aggregate Deposits	1,49,273	18.4 (15.2)	99,320	13.9	1,00,010	10.4	1,08,239	13.3 (10.2)
Demand Deposits	15,185	11.9	9,943	8.5	-64	0.0	2,478	1.9
Time Deposits	1,34,088	19.5	89,376	15.0	1,00,074	12.2	1,05,761	15.4
Bank Credit	75,476	17.3	67,121	18.2	37,256	7.3	49,615	11.4
Food Credit	14,300	55.7	8,875	52.8	11,772	29.4	11,255	43.8
Non-food Credit	61,176	14.9	58,246	16.5	25,484	5.4	38,360	9.3
Investments	61,215	19.8	54,349	21.3	59,510	16.1	46,664	15.1
Government Securities	61,579	22.1	55,238	24.7	59,325	17.4	46,770	16.8
Other Approved Securities	-364	-1.2	-889	-2.8	186	0.6	-105	-0.3

P: Provisional. Parenthetic figures are net of IMDs.

1.45 The low non-food credit off-take reflects, to a large extent, the sluggish performance of the industrial sector as well as the depressed investment climate. However, there has been an increase in non-food credit off-take since the latter half of September 2001 with the major part (Rs.19,830 crore) of the total incremental non-food credit (Rs.25,484 crore) during the current fiscal year so far attributable to the period of September 7 - November 16, 2001. (Chart I.33).



1.46 An analysis of the deployment of non-food gross bank credit of select scheduled commercial banks during 2001-02 so far (up to September) suggests that the priority sector credit off-take decelerated to 2.4 per cent (from 5.4 per during the corresponding period of the previous year) driven by lower credit off-take in agriculture (4.0 per cent as against 6.4 per cent last year) and other priority sectors (8.4 per cent from 14.1 per cent last year). Bank credit to the small-scale industries registered a decline (4.2 per cent on top of a decline of 1.1 per cent during April-September 2000). The credit availed by wholesale trade (other than food procurement) declined by 5.6 per cent (increased by 4.3 per cent last year) while that by the medium- and large-scale industries declined by 0.3 per cent (in contrast to an increase of 7.6 per cent last year).

1.47 A sectoral analysis shows that the slowdown of credit off-take in medium- and large-scale industry had been the principal source of the overall slowdown of credit off-take during the year so far (Table 1.9 and Chart I.34).

Table 1.9 : Sectoral and Industry-wise Deployment of Gross Bank Credit of Scheduled Commercial Banks (Fiscal Year Variations)

(Rupees Crore)

Sector/Industry	2000-01 (up to September)		2001-02 (up to September)	
	Absolute	Per cent	Absolute	Per cent
1	2	3	4	5
Priority Sector #	7,173	5.4	3,633	2.4
Industry (Medium and Large)	11,214	7.6	-419	-0.3
Whole Sale Trade (Other than food procurement)	721	4.3	-995	-5.6
Other Sectors	2,771	3.5	3,874	4.1
Export Credit	891	2.3	-4,748	-11.0
Petroleum	2,916	32.5	-2,712	-23.4
Infrastructure	1,561	21.6	361	3.2
Chemical Group	1,870	8.0	402	1.7
Electricity	1,560	21.0	207	2.4

:Excluding investments in eligible securities.
Note : Data are provisional and relate to 50 scheduled Commercial banks.

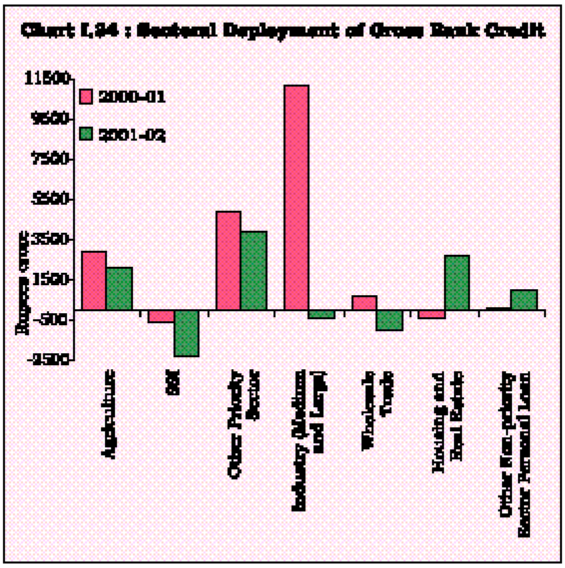
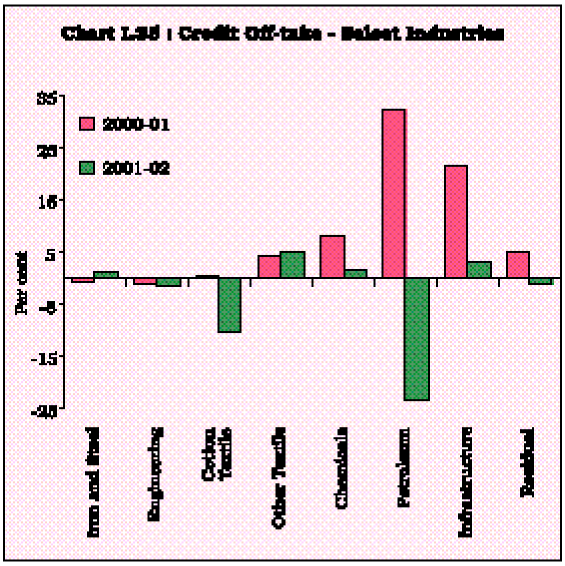


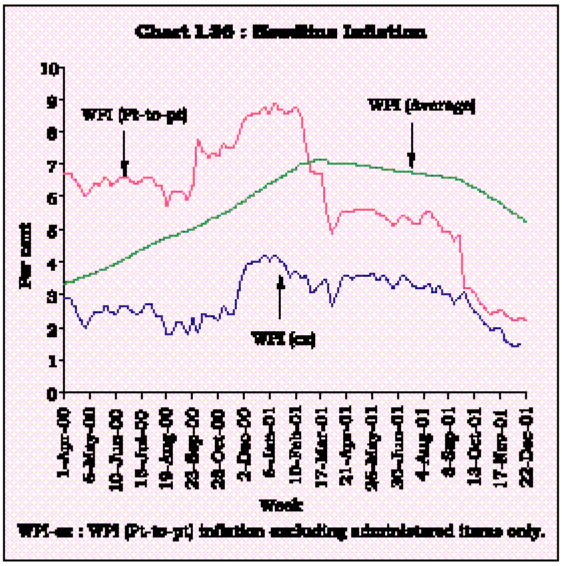
Chart I.34 : Sectoral Deployment of Gross Bank Credit

1.48 The industry-wise deployment of gross bank credit shows that most of the industries have exhibited deceleration/decline in terms of credit off-take during the financial year so far. Amongst the principal industries, credit off-take improved only in case of iron and steel (an increase of 1.1 per cent as against a decline of 0.9 per cent last year) and other textile (5.0 per cent as against 4.2 per cent) industries. On the other hand, for industries like infrastructure (3.2 per cent growth as against 21.6 per cent), cotton textiles (a decline of 10.0 per cent as against a growth of 0.5 per cent), chemicals, dyes, paints, *etc.*, (1.7 per cent growth as against 8.0 per cent) and petroleum (a decline of 23.4 per cent as against a growth of 32.5 per cent), credit demand slowed down significantly (Chart I.35).

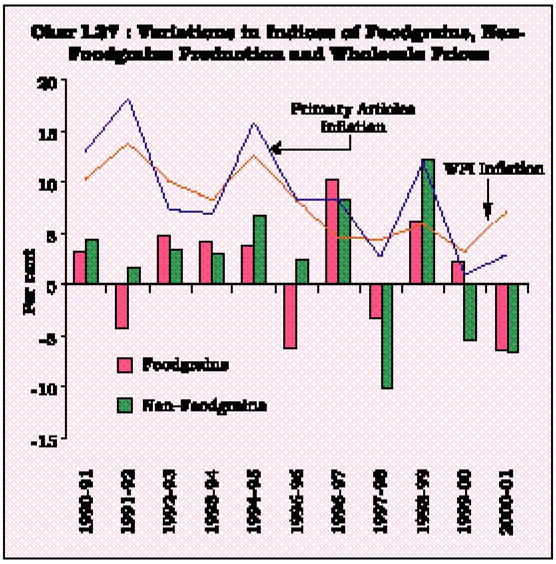


The Price Situation

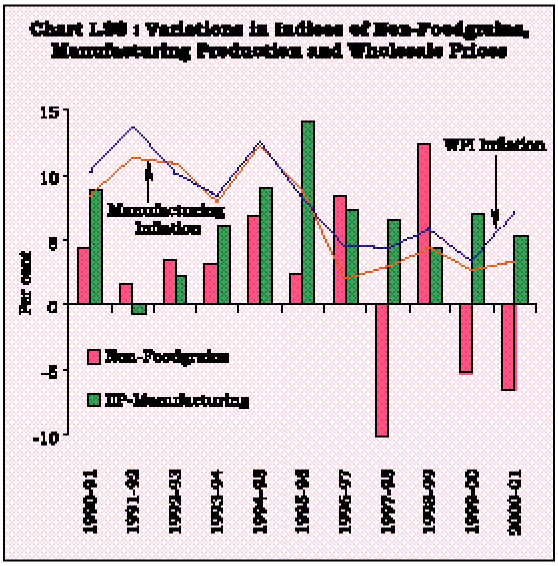
1.49 Inflation in 2001-02 represents a combination of factors - waning of the effect of successive rounds of administered price revisions in 2000-01, the improvement in agricultural production and the continuing slack in manufacturing prices - and the absence of demand pressures - sluggishness in the investment demand, excess capacities in various industries and inventory accumulation - along with a moderate firming up of primary articles prices. The annual point-to-point wholesale price index (WPI) inflation declined from 5.1 per cent at the beginning of the year to a low of 2.2 per cent as on December 22, 2001 as compared with 8.6 per cent as on December 23, 2000. The upward movement in inflation on account of the administered price revisions in 2000-01 imparted a statistical bias, vitiating comparisons of the current year's inflation with that in the preceding year. This is further corroborated by the movement of WPI inflation excluding the effect of administered price hikes on a point-to-point basis (WPI-ex) which remains vertically below the actual inflation for a greater part of the year on account of the wedge caused by the price revisions last year (Chart I.36).



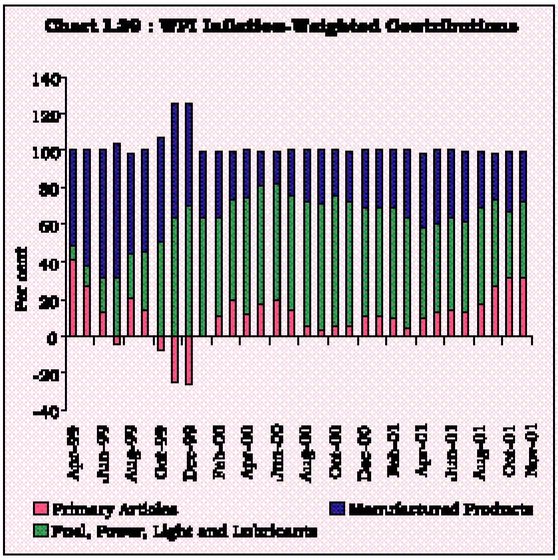
1.50 Average annual WPI inflation, measuring underlying inflation (as against the official measure of headline inflation on the basis of year-on-year WPI movements) has been falling consistently during the year, decelerating to 5.2 per cent as on December 22, 2001 from 6.2 per cent during the corresponding period last year. During the financial year so far up to December 15, 2001, on an average basis, primary articles inflation accelerated to 3.9 per cent from 3.2 per cent during the corresponding period last year, mainly on account of lagged effects of variability in agricultural production in terms of foodgrains and non-foodgrains production (Chart I.37). On the other hand, the fuel inflation dropped significantly to 8.6 per cent as on December 15, 2001 from 25.2 per cent a year ago. Manufacturing inflation also decelerated to 1.9 per cent from 2.6 per cent during the corresponding period of the last year, explained partly by the lower input costs for industrial production (including lower fuel price inflation), improved *kharif* production and the global decline in the prices of manufactures.



1.51 The fall in inflation during the year is the result of significant deceleration in fuel inflation (on account of base effect correction) and low manufacturing inflation, as apparently industrial prices are leading the current disinflation (Chart I.38). Identifying and understanding the sensitivity of prices to cycles in agricultural and industrial activity will, therefore, help to gauge the prospects of the recovery.



1.52 During the current financial year so far (up to December 15, 2001), on an average basis, the fuel group contributed the maximum to inflation with a share of 45.5 per cent even though it was substantially lower than that of 63.1 per cent during the corresponding period of the last year. This was followed by the manufactured products and primary articles groups' contributions at 30.7 per cent and 24.8 per cent as against 24.9 per cent and 12.2 per cent, respectively, during the comparable period a year ago. On a monthly average basis also the fuel group contributed the maximum to the price rise during the year so far (Chart I.39).



1.53 The inflation rate at the retail level, as measured by the annual variation in consumer price index for industrial workers (CPI-IW) on a point-to-point basis, increased to 4.9 per cent in November 2001 from 2.7 per cent in November 2000 (moving within a range of 2.5-5.5 per cent in 2000-01), reflecting mainly the upward trend in the prices of food items. Thus, in recent years, there is divergent movement between the consumer price inflation and wholesale price inflation (Chart I.40).

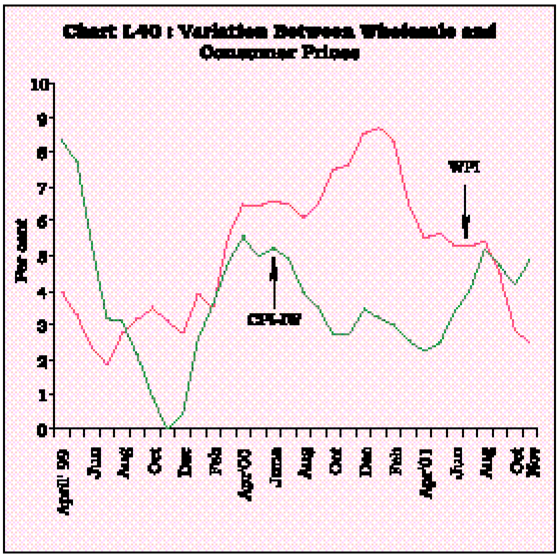


Chart I.40 : Variation Between Wholesale and Consumer Prices

1.54 The new lows reached in India's inflation record during 2001-02 and falling inflation worldwide has opened up the debate on the costs associated with the disinflation. This raises the issue of the effectiveness of monetary policy in a phase of economic slowdown in India. It also brings to the forefront the need to appropriately assess inflationary conditions - partly in view of the divergent movements of different measures of inflation in recent years - with a view to getting a 'fix' on inflationary expectations for setting forward-looking monetary policy (Chart I. 41).

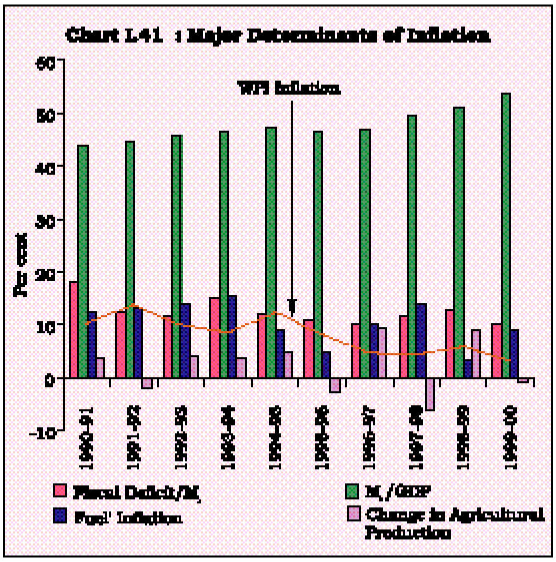


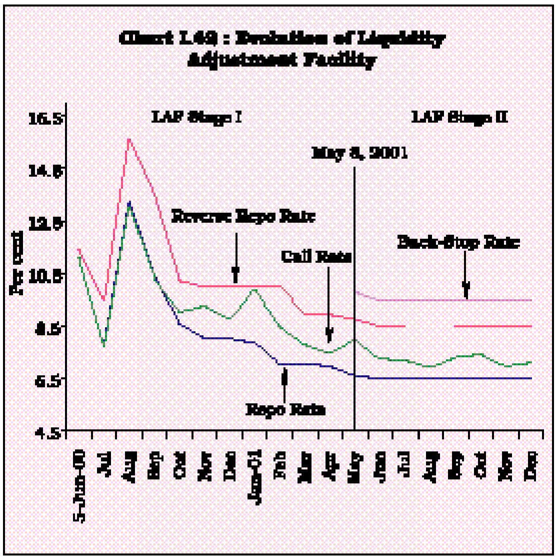
Chart I.41 : Major Determinants of Inflation

Financial Markets

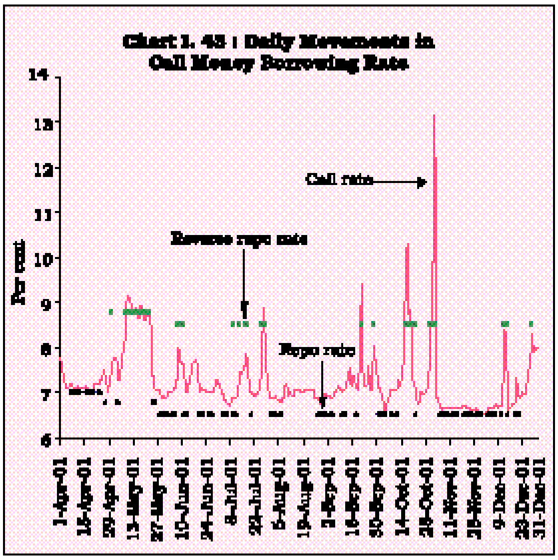
1.55 Financial markets remained calm over most of the year except for a brief period of volatility witnessed during the middle of September 2001 after the terrorist attack on the US. The call money rates were range-bound as the liquidity conditions were comfortable. The foreign exchange market exhibited stable conditions with capital inflows creating conditions of comfortable supply. There was a fall in the yields across all maturities in the Government securities market. Reflecting the general economic conditions and the growing cross-border integration, the capital market was subdued during the first half of the year, with signs of moderate recovery emerging only during the third quarter of 2001-02.

Call Money Market

1.56 The money market conditions remained comfortable during 2001-02 (up to December) with the Reserve Bank continuing to modulate liquidity appropriately in tune with underlying real and financial developments. The transition to the second stage of the LAF, introduced with effect from May 8, 2001 was smooth and barring a few exceptions, the overnight call money rate remained around 7.0 per cent, well within the repo-reverse repo corridor (Chart I.42). Ample liquidity conditions prevailed on account of the strong mobilisation of bank deposits without any commensurate off-take of non-food credit. The reduction in the CRR also enhanced liquidity in the system.



1.57 The current financial year commenced with the usual comfortable liquidity conditions up to May 8, 2001 reflecting seasonal easing of liquidity. The weighted average call money borrowing rate hovered slightly above 7.0 per cent during April 2001 edging beyond only in the first week of May 2001. The repo and reverse repo cutoff rates declined by 25 basis points each to 6.75 per cent and 8.75 per cent, respectively, reflecting easy conditions. The weighted average call money borrowing rate spurted to 9.13 per cent on May 9, 2001 and remained above the ceiling of the repo-reverse repo corridor till May 19, 2001 under the second stage of LAF as a result of the floatation of State government loans and the rally in the Government securities market. A series of liquidity injections in the form of reverse repos (averaging an outstanding amount of around Rs.3,340 crore during May 8-25, 2001) as well as a cut in the CRR by 50 basis points to 7.5 per cent of net demand and time liabilities, effective May 19, 2001 could nudge the call rates back to the corridor by May 21, 2001 (Chart I.43).



1.58 The liquidity conditions remained comfortable throughout June-December barring stray spurts in the call money rate. The repo cut-off rate was further reduced by 25 basis points to 6.5 per cent on May 28, 2001 and the reverse repo cut-off rate was also reduced by 25 basis points to 8.5 per cent on June 7, 2001. Low advance tax outflows enabled the average of weighted average call money borrowing rates to remain comfortable around 7.2 per cent during June 2001, contrary to the usual seasonal pattern. The Reserve Bank absorbed excess liquidity through repos. Redemption payments augmented market liquidity and ensured easy call rates in July-August 2001. Excess liquidity was absorbed through repos as well as open market sales.

Notwithstanding the uncertainty created by the external disturbance of September 11, 2001, the weighted average call money rates remained within the repo-reverse repo corridor during the month, hardening somewhat to 9.4 per cent on September 21, 2001 in consonance with turbulence experienced in equity and foreign exchange markets. There was some tightness in liquidity experienced during October 16-19, 2001. The weighted average call money rates moved above the reverse repo cut-off rate mainly on account of a series of outflows (Rs.8000 crore on account of the twin gilt auctions held on October 15, 2001 and T-bills auctions) and the usual pressures from fulfilling the reporting requirements for maintenance of the CRR in the second week of the reporting fortnight. Thereafter, the average of the call money borrowing rate (weighted average) remained within the informal corridor.

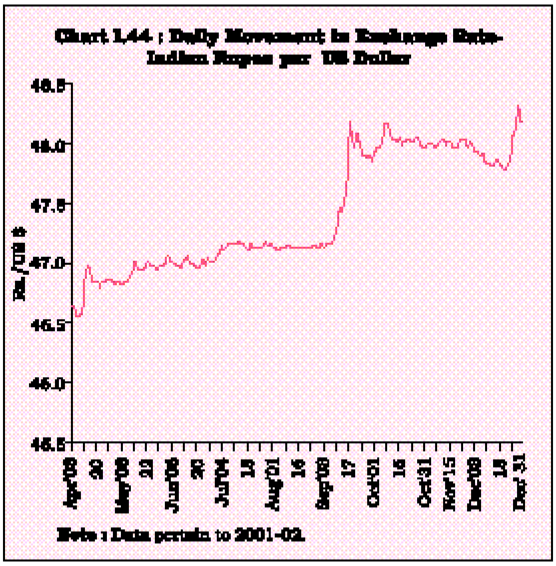
1.59 The money market conditions were strained in the second week of the fortnight ending November 2, 2001 as market participants rushed to fulfill their reporting requirements. The call money borrowing rate shot up to an intra-day high of 22.0 per cent with the weighted average-rate also peaking for the year to 13.1 per cent as on November 2, 2001. Liquidity was injected with the outstanding amount of reverse-repo averaging at Rs.5,917 crore during October 30-

November 2, 2001. Liquidity conditions improved with the first CRR cut becoming effective and the weighted average call money borrowing rate dropped to 6.9 per cent on November 3, 2001. Liquidity was further augmented in the system with inflow of funds in the form of coupon and redemption receipts as well as unsterilised expansion in the net foreign exchange assets of about Rs.8000 crore (net of revaluation). Heavy subscriptions in the repo auctions reflected considerable easing of liquidity conditions and the weighted average call money borrowing rate hovered mostly around 6.6 per cent.

1.60 The call money rates remained generally comfortable during December 2001. There was, however, a spurt during December 12-14, 2001 as well as some hardness in the call rates towards the end of the month. The liquidity conditions tightened in the first instance on account of outflows towards the twin gilt auctions in the first week of December 2001 amounting to Rs. 6,000 crore and open market sales (gross) of around Rs. 7,863 crore during the first fortnight of December 2001. The pressure of fulfilling the reporting requirements towards the second week of the reporting fortnight ended December 14, 2001 took the intra-day high rate beyond the repo-reverse repo corridor prompting some liquidity injection through reverse repos. After reverting to the corridor with the commencement of the new reporting fortnight, call rates hardened towards the end of December 2001 due to advance tax outflows and the intra-day high touched 12.0 per cent on December 28, 2001. As the second cut of 25 basis points in the CRR became effective from fortnight beginning December 29, 2001, the call rates declined. The weighted average call money rates remained, however, within the corridor during December 2001.

Foreign Exchange Market

1.61 The foreign exchange market generally exhibited stable conditions during April-December, 2001-02 on account of comfortable supply position due to inflows on account of FIIs, FDI, non-resident deposits and raising of resources from abroad through ADR/GDRs by Indian corporates. The exchange rate of the rupee moved within a range of Rs.46.56-Rs.48.34 per US dollar during this period, abstracting from minor episodes of sporadic volatility mainly on account of uncertain market sentiment, high oil prices and political events. The exchange rate of the rupee which stood at Rs.46.64 per US dollar as at end-March 2001 depreciated marginally by 1.1 per cent to Rs.47.15 per US dollar at end-August 2001. The downgrading of India's sovereign outlook in August 2001 from stable to negative by two international rating agencies, however, failed to have any significant impact on the market (Chart I.44).



1.62 The foreign exchange market witnessed some uncertainty during September 2001, after the terrorist attacks in the US on September 11, 2001. The market sentiment was adversely affected by fears of US reprisal, deceleration in FII inflows after the attack and a further slowdown in India's exports. As a result, the Indian rupee experienced a depreciation from Rs.47.45 per US dollar on September 11, 2001 to Rs.48.18 per US dollar on September 17, 2001. Normalcy soon returned in the foreign exchange market. In October and November 2001, the foreign exchange market witnessed stable conditions amidst steady supply of dollars and modest corporate demand. Net FII investment, which turned negative during September 2001, resumed since October 2001 buoyed by the decision to increase the FII investment limit up to the sectoral cap/ statutory ceiling of FDI, as applicable. The foreign exchange market witnessed heightened activity during the last week of December 2001, which led to depreciation of rupee by 0.4 per cent to close the month of December 2001 at Rs.48.18 per US dollar.

1.63 Against other major currencies like euro, pound sterling and Japanese yen, the exchange rate of the rupee appreciated since October 2001; the rupee had depreciated significantly against these currencies during the period July to September 2001 (Chart I.45).

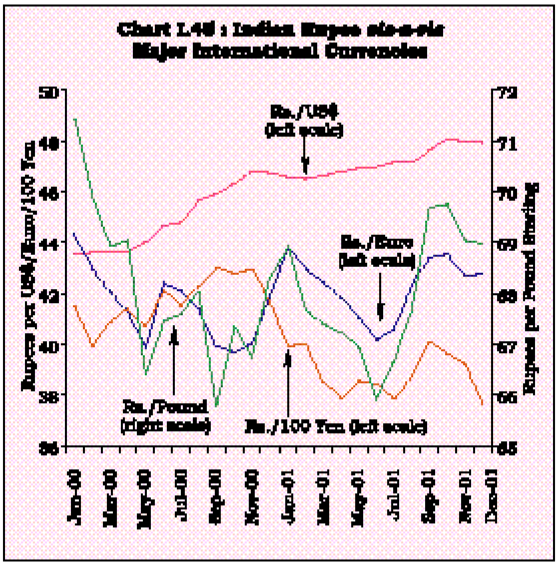


Chart I.45 : Indian Rupee vis-a-vis Major International Currencies

1.64 In the foreign exchange market, the average monthly total turnover increased to US $ 119 billion during 2001-02 (April-September 2001), from US $ 116 billion in 2000-01. Monthly turnover in the merchant segment of the foreign exchange market moved within the range of US $ 19.8-23.1 billion, while in the inter-bank segment, the turnover moved in a range of US $ 83.5-107.6 billion during the first two quarters of the year 2001-02. There was some decline in the market turnover during October and November 2001. The ratio of inter-bank to merchant turnover, an indicator of hedging activity in the market hovered around 4, indicating orderly conditions (Chart I.46).

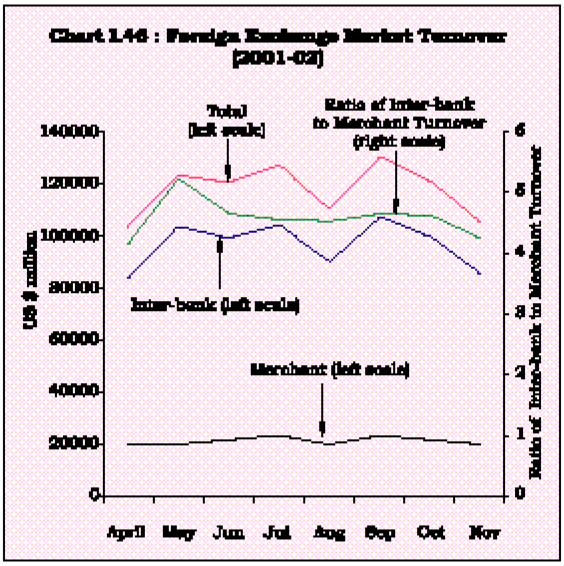
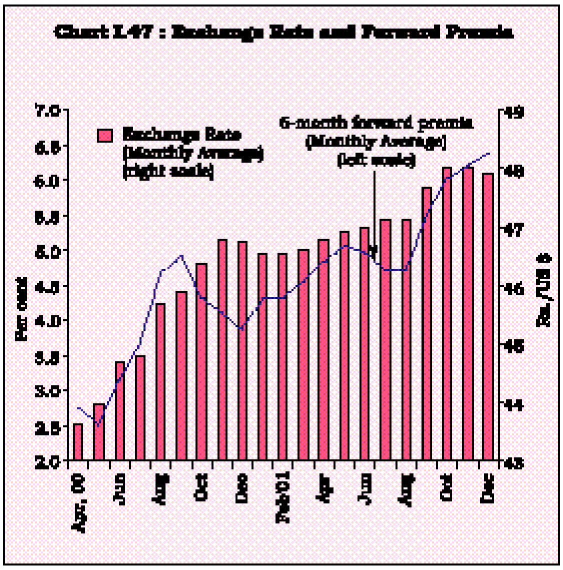


Chart I.46 : Foreign Exchange Market Turnover (2001-02)

1.65 The forward premia ruled easy for the first five months of 2001-02. The market tightened in the aftermath of the terrorist attack in the US and the disturbances in Afghanistan, with the 3-month and the 6-month forward premia hardening to 6.02 per cent and 6.03 per cent, respectively, in October 2001 from 4.5 per cent and 4.7 per cent, respectively, in August 2001 (Chart I.47). The 3-month and 6-month forward premia further hardened to 6.34 and 6.36 per cent, respectively, during December 2001.

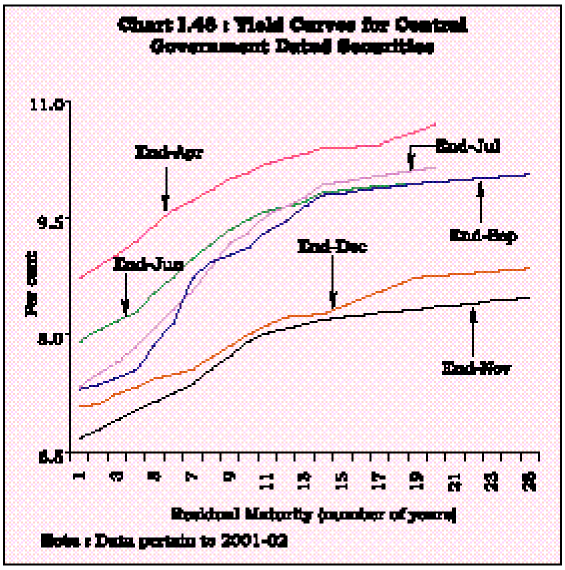


Government Securities Market

1.66 The Government securities market was driven by easy liquidity conditions facilitated by monetary easing. Furthermore, the series of interest rate cuts in the developed economies fuelled expectations of similar interest cuts in India and turned the domestic gilt market sentiment buoyant. Gilt prices surged across the spectrum with the yields of dated securities of 5-year, 10-year, 15-year and 20-year maturity declining by 226 basis points, 217 basis points, 217 basis points and 234 basis points, respectively, to 7.14 per cent, 7.91 per cent, 8.23 per cent and 8.36 per cent, respectively, during 2001-02 (up to November 30). However, the gilt market exhibited considerable volatility in December 2001. The yields across the entire maturity spectrum hardened by end-December 2001. The comfortable liquidity conditions enabled the Central Government to complete net market borrowings of Rs.79,002 crore (around 102 per cent) and gross market borrowings of Rs.1,16,002 crore (around 98 per cent) by December 28, 2001 with a sizeable amount raised in the early part of the year itself in the face of sluggish demand for non-food credit.

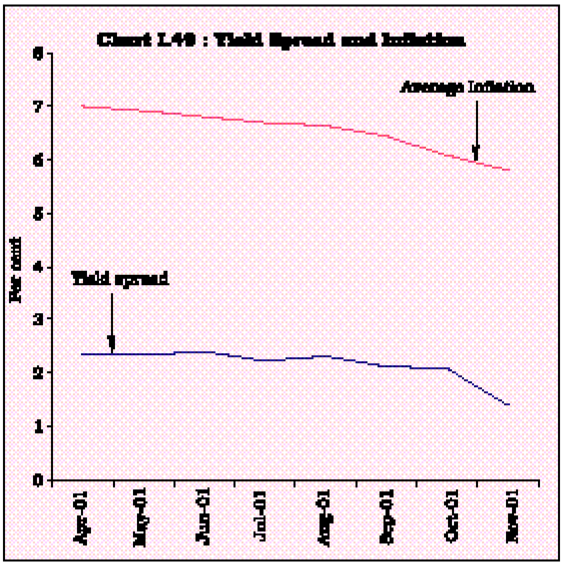
1.67 In the primary market, the Central Government completed around a quarter of its budgeted gross market borrowing programme for 2001-02 during April 2001 itself with ratio of bid amount/notified amount (BA/NA) of 1.7 reflecting favourable market response. The BA/ NA ratio remained more than unity at each of the auctions during 2001-02 (upto December). About 25 per cent of the Centre's fresh gross borrowing was privately placed with /devolved on the Reserve Bank. In order to neutralise the monetary impact of private placements, the Reserve Bank conducted outright OMO sales (net) of Rs.30,187 crore (up to December 28). The Central Government was able to elongate its weighted average maturity of borrowing to 14.1 years so far in 2001-02 (up to December) from 10.6 years last year. The Central Government auctioned a security with the longest tenor of 25-year on September 11, 2001 for a notified amount of Rs.2,000 crore which received a bid of Rs.3,844 crore. Apart from lengthening the maturity, the Government was able to reduce its cost of borrowing with the weighted average yield on borrowings being lower by more than 100 basis points at 9.7 per cent as against around 11.0 per cent last year. The Central Government auctioned Floating Rate Bonds 2006 for the first time on November 21, 2001 for Rs.2,000 crore with the interest rate of the bond having two components, *viz.*, a *variable* base rate linked to the 364-day Treasury Bill rate (average implicit yield in the immediate previous six auctions held prior to the relative half-year coupon period) and a *fixed* mark-up decided in the auction. A substantially high bidding amount in this auction reflected market propensity to a floating interest rate paper.

1.68 In the secondary gilt segment, there was a persistence of the rally in prices except for brief halts in July, September and December 2001 (Chart I.48). The easy liquidity conditions coupled with a softer interest rate environment enabled a reduction in the yields throughout the maturity spectrum, more prominently at the short-end, during April-June 2001. The rally was, however, arrested by the Reserve Bank's open market sales auction on July 12, 2001. Sentiment turned bearish for the securities at the long-end and there was a switch towards securities of short-tenor. During July 2001 the yield curve steepened with yields of gilts of 5-year and 10-year residual maturities moving down by 46 basis points and 18 basis points, respectively, while those of 15-year and 20-year residual maturities hardened by 11 basis points and 18 basis points, respectively. The easing of liquidity conditions and expectations of an interest rate cut amidst a softer international interest rate environment resumed the rally in the gilt market in August 2001.



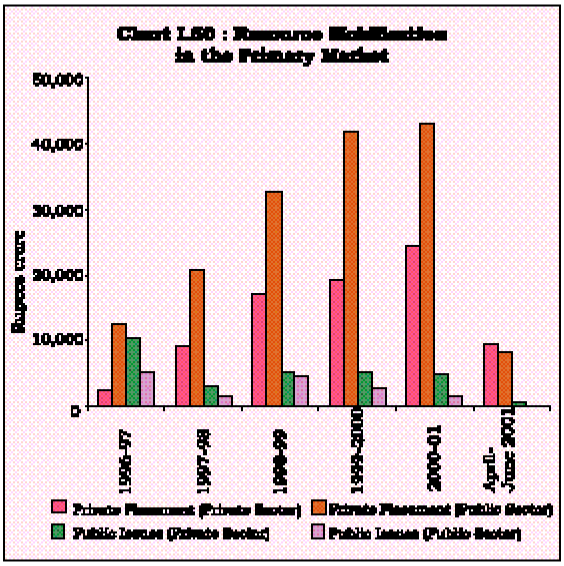
1.69 The gilt market continued to evince interest for securities of short and medium-tenors in early-September with some uncertainty in the foreign exchange market adding a note of caution. Subsequent to the terrorist attack in the US, the gilt market turned bearish. A series of open market purchases amounting to Rs.5,084 crore were conducted to provide support to the gilt prices throughout the maturity spectrum and ensured stability in gilt prices during the month.

1.70 International interest rates continued to soften in October, 2001. Measures announced in the mid-term review of monetary and credit policy for 2001-02 fuelled a resurgence in the gilt prices throughout the maturity spectrum in October and November 2001. Amidst easy liquidity conditions, the yield level of the security of the longest tenor, *i.e.*, 25-year, declined by 127 basis points to 8.5 per cent during November 2001. The yield on the benchmark 10-year paper touched a historic low of 7.8 per cent on December 5, 2001. Subsequently, the OMO sales checked further rally and made the gilt prices range-bound. The bid-ask spread in the government securities market widened and turnover in the dated securities market fell sharply from Rs. 74,888 crore during the week ended December 7 to Rs. 22,161 crore during the week ended December 21, 2001. The yield curve shifted up by end-December 2001 in relation to a month ago with the yields moving up especially for short and long-tenors. While the yields of the securities with 5-year and 20-year tenors hardened sharply by 31 basis points and 40 basis points, respectively, the yield on the 10-year benchmark security moved up by 9 basis points during December 2001. During 2001-02 (up to November), the yield spread (difference between yields of 10-year Government securities on residual maturity basis and 91-day Treasury Bills) has moved synchronously with the path of the average inflation rate (Chart I.49).

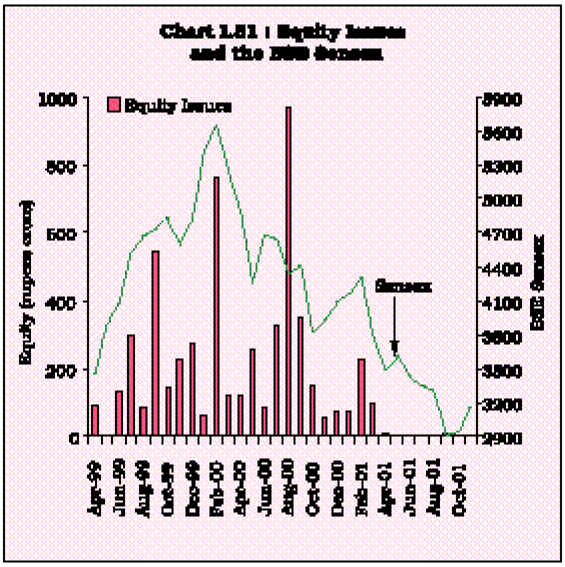


Capital Market

1.71 The capital market remained subdued for the greater part of 2001-02, reflecting the general economic conditions as well as the co-movement with international stock exchanges. Resource mobilisation from the new issues market continued to be depressed in line with recent trends. The private placement market, which has witnessed a manifold increase over the public issues market in recent years, continued to record substantial growth. During 2001-02 (up to June), the private placement market witnessed increased activity as Rs.17,657 crore was raised, registering a growth of 91.7 per cent as compared with Rs.9,213 crore raised during the comparable quarter of the previous year (Chart I.50).



1.72 The public issues market witnessed depressed conditions during 2000-01 (up to November) as only nine issues aggregating Rs.2,023 crore were floated by the non-Government public limited companies (private sector) as compared with Rs.3,266 crore raised through 116 issues during April-November 2000 and Rs.4,924 crore raised through 142 issues during the full year 2000-01. There were only three equity issues aggregating Rs.21 crore during 2001-02 (up to November) as compared with 110 equity issues aggregating Rs.2,261 crore during the corresponding period of the previous year, reflecting the downturn in capital market conditions (Chart I.51). Despite lower resource mobilisation, the average issue size increased sharply to Rs.225 crore from Rs.28 crore during the corresponding period of the previous year. Five bond issues from the ICICI of Rs.400 crore each constituted 98.9 per cent of the total resource mobilisation during April-November 2001. There was no issue from the public sector as against three issues aggregating Rs.772 crore during April-November 2000 and five issues aggregating Rs.1,472 crore during the full financial year 2000-01.



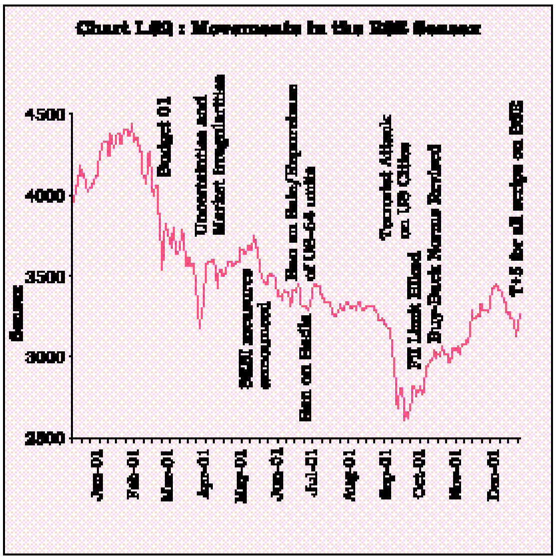
1.73 With a view to containing risks arising out of non-SLR investments' portfolio of banks and FIs, the mid-term review of monetary and credit policy for the year 2001-02 proposed to introduce further guidelines covering such aspects as strengthening of the internal rating system, fixing of prudential limits with separate sub-limits for unrated, unquoted and privately placed instruments, review by board in respect of issuers and non-performing investments and disclosures regarding issuer composition and non-performing investments, *etc.*

1.74 According to the SEBI, net resource mobilisation by mutual funds, at Rs.8,744 crore during April-November 2001, increased by 28.6 per cent as compared with Rs.6,800 crore during the comparable period of the previous year and Rs.9,128 crore during the full year 2000-01, mainly due to the substantial funds raised by the debt-oriented schemes. The Unit Trust of India (UTI), however, witnessed a net outflow of Rs.5,046 crore during the year. The share of resource mobilisation as well as assets under management by the private sector increased during the second half of the 1990s, while that of UTI declined.

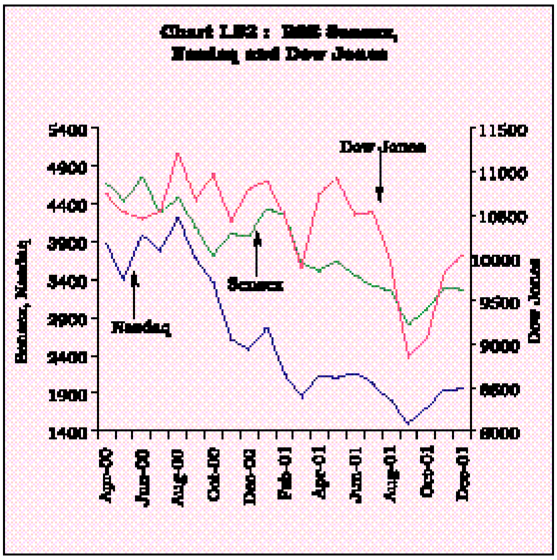
1.75 Financial assistance sanctioned and disbursed by the term-lending institutions at Rs.52,123 crore and Rs.37,367 crore, respectively, declined sharply by 26.9 per cent and 9.7 per cent, respectively, during April-November 2001 as compared with 12.3 per cent and 12.0 per cent growth, respectively, during the corresponding period of the previous year, largely reflecting the persistence of the industrial slowdown.

Secondary Market

1.76 The equity markets began the year on a depressed note with the BSE Sensex sliding below the 3500 mark by June 2001 and declined further to touch 3245 by end-August 2001 (Chart I.52). Market sentiment was dampened by certain adverse developments in domestic stock exchanges including apprehensions of payment difficulties (in March 2001) notwithstanding a market-friendly Union Budget 2001. The market was also adversely affected by the continuing decline in the Nasdaq, recessionary global conditions and the domestic economic slowdown. The ban announced by the UTI on the sale and repurchase of US-64 units in July 2001 also had a dampening effect on the market.



1.77 The markets witnessed a sharp downturn in September 2001 mirroring global reactions to the September 11, 2001 terrorist attacks on the US (Chart I.53). The BSE Sensex declined by 17.5 per cent to 2600 on September 21 - the lowest level since September 8, 1993. The Reserve Bank permitted banks to extend finance to stockbrokers for margin trading on September 18, 2001 and hiked FII investment limit from 49 per cent to sectoral limits allowed for FDI.



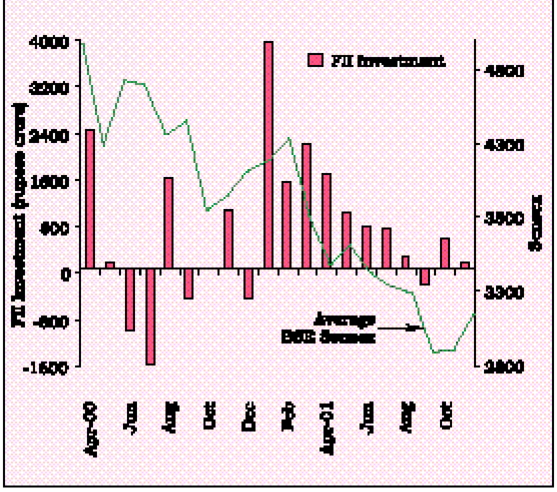
1.78 The stock markets recovered somewhat in October 2001 (with the BSE Sensex crossing the psychological 3000 mark for the first time on October 16, 2001 in intra-day trading) and November 2001, especially as fears relating to the disturbances in Afghanistan were discounted. Besides, the stronger-than-expected second quarter results of some major corporates, especially in the software sector, improved the market sentiment. Policy measures such as the Government's long awaited move to relax share buy-back up to 10 per cent with board approval instead of the shareholders' approval needed earlier, monetary easing (in October 2001) and introduction of stock futures in 31 scrips by the SEBI (in November 2001) also buoyed markets.

The BSE Sensex showed a steady rise to 3288 by end-November 2001 and 3443 as on December 10, 2001. Reflective of this, the turnover in the BSE rose to Rs.24,402 crore in November 2001 from Rs.21,593 crore in September 2001. However, the rally was somewhat arrested in December 2001 in the wake of a weakening market sentiment.

1.79 The monthly average of BSE Sensitive Index, which stood at 5262 during March 2000 declined to 3808 during March 2001 and declined further to 2918 during September 2001 but thereafter recovered to 3315 during December 2001. The volatility in share prices as measured by the coefficient of variation, at 7.6 per cent during April-December 2001, was lower than 9.0 per cent during the corresponding period of the previous year.

1.80 Foreign Institutional Investors' (FIIs) investments increased to Rs.5,116 crore during April-November 2001 as compared to Rs.2,394 crore during the corresponding period of the preceding year (Chart I.54). Net FII inflows in equity markets remained positive during 2001 so far with the exception of September 2001. In contrast, the mutual funds remained net sellers in equity markets during 2001 so far, with the exception of September 2001.

Chart 1.54 : BSE Sensex and FII Investment



1.81 On May 14, 2001 the SEBI announced a ban on all deferral products in the cash segment including *badla* from July 2001 with a view to segregating the cash and futures market and introduced rolling settlement in the active scrips along with some other significant changes in the capital market in keeping with the international practices. On December 19, 2001, the SEBI announced that the T + 5 rolling settlement cycle would further be shortened to T + 3, effective April 1, 2002. On December 31, 2001 all the scrips listed on the BSE moved to compulsory rolling settlement mode.

Financial Sector

Scheduled Commercial Banks (SCBs)

1.82 During the financial year 2000-01, SCBs recorded a 7.9 per cent increase in operating profits which went up to Rs.19,747 crore as on March 31, 2001. Net profits, however declined by 11.3 per cent to Rs.6,424 crore as on March 31, 2001, driven by the increase in provisions partly offset by higher operating profits. The ratio of net profit to total assets of SCBs declined from 0.66 per cent in 1999-2000 to 0.50 per cent in 2000-01 (Chart I.55). As at end-March 2001, gross non-performing assets (NPAs) as a percentage of total assets for SCBs declined to 4.9 per cent from 5.5 per cent as at end-March 2000. As a share of gross advances, gross NPAs of SCBs declined to 11.4 per cent as at end-March 2001 from 12.7 per cent in the previous year. The ratios of net NPAs to total assets and net advances declined to 2.5 per cent and 6.2 per cent, respectively, as at end-March 2001 from 2.7 per cent and 6.8 per cent, respectively, as at end-March 2000 (Chart I.56).

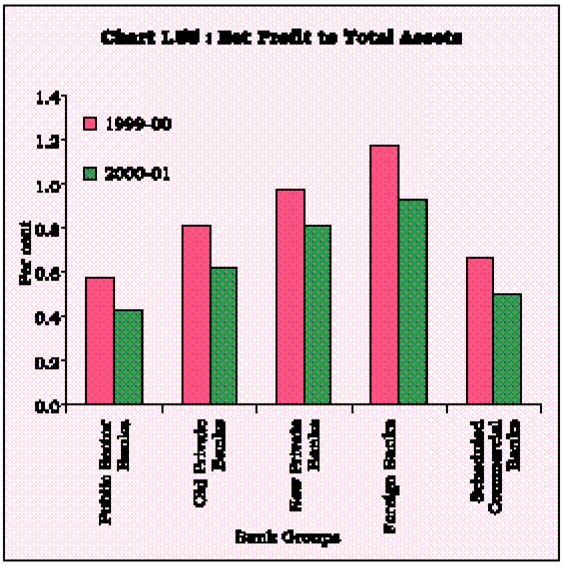


Chart I.55 : Net Profit to Total Assets

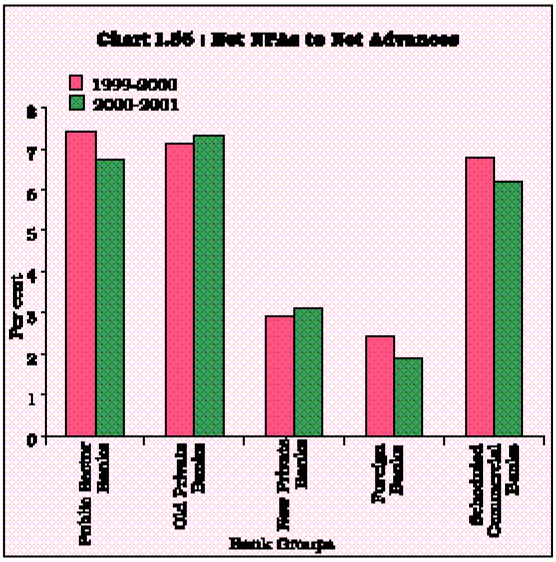


Chart I.56 : Net NPAs to Net Advances

1.83 As at end-March 2001, 84 out of 100 SCBs recorded capital to risk-weighted asset ratio (CRAR) in excess of 10 per cent. Eleven banks had CRAR between 9 per cent and 10 per cent, while five banks had CRAR below the 9 per cent mark.

Co-operative Banks

1.84 At the end of March 2001, the number of urban co-operative banks (UCBs) stood at 2,084, of which 90 were salary earners' banks. Information on the financial performance relating to profits/losses during 1999-2000 are available for 1,747 banks, which roughly cover 84 per cent of the total UCBs. Of these UCBs, 1,499 banks registered profits while the rest incurred losses.

Scheduled UCBs

1.85 Total deposits and advances of the 51 scheduled UCBs as at end-March 2001 were Rs.33,164 crore and Rs.21,511 crore, respectively. The total income increased by 17.2 per cent during the financial year 2000-01. Interest income contributed 93.3 per cent of the total income of the scheduled UCBs. The total expenditure of the scheduled UCBs increased by 49.7 per cent in 2000-01.

Financial Institutions

1.86 The profitability analysis of the 10 FIs indicates that the combined net profits of these institutions registered a decline of 35.1 per cent during the year 2000-01. The ratios of net NPA to net loans as on March 31, 2001 in respect of ICICI, Small Industries Development Bank of India (SIDBI) and EXIM Bank were below 10 per cent, while that of Industrial Finance Corporation of India (IFCI), Industrial Development Bank of India (IDBI), Industrial Investment Bank of India (IIBI), and Tourism Finance Corporation of India (TFCI) ranged between 14-23 per cent. The CRARs of all the financial institutions (except IFCI) were well above the benchmark minimum of 9.0 per cent.

Non-Banking Financial Companies (NBFCs)

1.87 As at end-March 2000, the total quantum of outstanding public deposits reported by 1,005 reporting companies, was Rs.19,342 crore, equivalent to 2.2 per cent of the aggregate deposits (Rs.8,96,696 crore) of scheduled commercial banks. The aggregate assets of the NBFC sector increased to Rs.51,324 crore as on March 31, 2000, from Rs.47,049 crore, as on March 31, 1999. Some of the companies have converted themselves into non-deposit-holding companies by repaying the deposits held by them. At the disaggregated level, public deposits with the hire purchase companies and residuary non-banking companies (RNBCs) increased by 22.3 per cent and 3.4 per cent, respectively.

Global Economic Situation

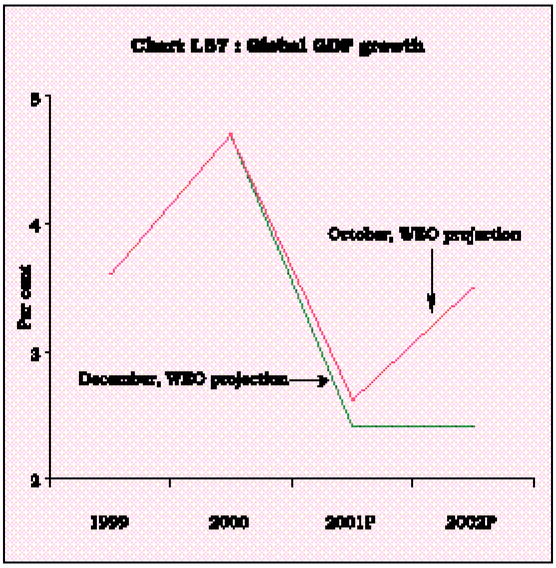
1.88 The deceleration in the global economy which started during the second half of 2000 deepened during 2001 with all the major regions of the world (excluding Africa) exhibiting a synchronised slowdown. The IMF revised downwards growth projections for the global economy in 2001 for the third time in December 2001 from 3.2 per cent (in May 2001) to 2.6 per cent (in October 2001) and finally, after incorporating the impact of the terrorist attack on the US on September 11, 2001, to 2.4 per cent *i.e.*, half the level of growth recorded in 2000 (4.7 per cent) (Table 1.10 and Chart I.57). The recovery is now expected to be delayed well into the second half of 2002 with the uncertainties associated with the terrorist attack further compounding the existing risks to the global economy.

Table 1.10 : Prospects for Global Growth

(Annual percentage change)

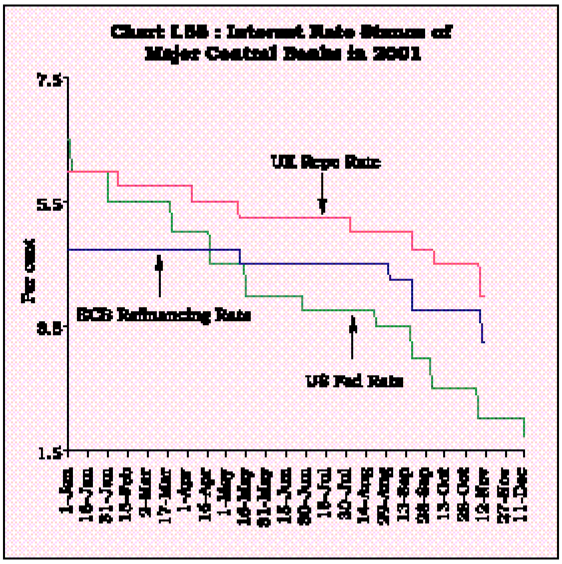
	December Projections				Difference from October 2001 Projections	
	1999	2000	2001	2002	2001	2002
1	2	3	4	5	6	7
World Output	3.6	4.7	2.4	2.4	-0.2	-1.1
Advanced Economies	3.3	3.9	1.1	0.8	-0.2	-1.3
Developing Countries	3.9	5.8	4.0	4.4	-0.4	-0.9
World Trade (Volume)	5.4	12.4	1.0	2.2	-1.8	-3.1
Oil Prices (US dollar)	37.5	56.9	-14.0	-23.7	-9.1	-15.1
Non-Oil Commodity Prices (US dollar)	-7.0	1.8	-5.5	1.7	-2.8	-2.7

Source : World Economic Outlook, IMF, December 2001.

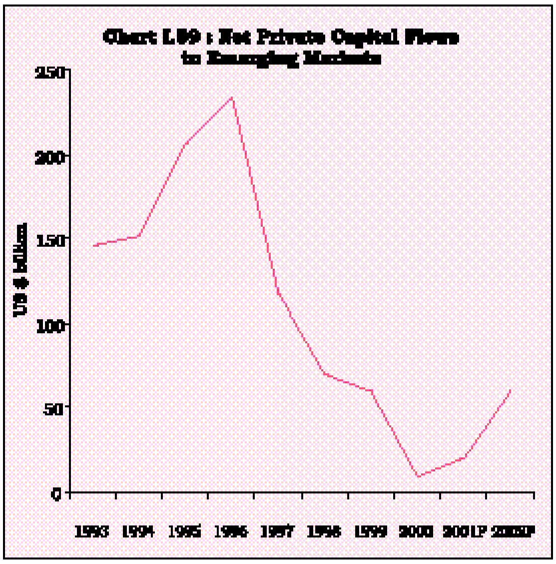


1.89 The impact of the global slowdown has been manifested in several associated developments: (i) growth in world trade volume (goods and services) which was projected in October 2001 to decelerate from 12.4 per cent in 2000 to 2.7 per cent in 2001 may suffer a further deceleration following the terrorist attack to 1.0 per cent (WEO, December 2001) owing to increased cost of transportation of goods and the expected further deceleration in economic activity; (ii) the positive effect of declining international interest rates on capital flows to emerging markets has been more than off-set by rising risk aversion of investors and deteriorating economic fundamentals in some of the emerging markets; (iii) there has been an accumulation of large scale macroeconomic imbalances with exchange rate misalignments; and (iv) there are distinct prospects of some deterioration in the terms of trade of developing countries.

1.90 A number of steps to counter the slowdown have been taken. Monetary policy in industrial countries has been eased considerably. The US Federal Reserve has lowered the federal funds rate eleven times during 2001 by 475 basis points (four times -cumulatively by 175 basis points after September 11) and is now at its lowest level (1.75 per cent). Similarly, the European Union and the UK have lowered the key policy rates (main refinance rate and repo rate, respectively) by 150 basis points and 200 basis points, respectively, during 2001 (100 basis points each in the post-terrorist attack phase) (Chart I.58). Japan has also lowered its official discount rate to near zero level (0.10 per cent) after the attack.



1.91 Emerging Asian economies have exhibited sharp slowdown in industrial production and exports since mid-2000. Besides the impact of global slowdown and the electronics cycle, political uncertainties and weakening confidence on account of slow paced structural reforms have contributed to the deceleration. The possibilities of a prolonged downturn in the US, a lagged recovery in the technology sector and the recession in Japan could further worsen emerging market growth prospects. Net capital flows to the emerging markets are projected to remain weak with modest recovery in 2001 (Chart 1.59)



External Sector

1.92 Reflecting the downturn in global economic activity, India's exports, which recorded a strong growth of 21.0 per cent in US dollar terms during 2000-01, increased marginally during the current fiscal year so far (April-November 2001) (Chart I.60). Provisional data of the Directorate General of Commercial Intelligence and Statistics (DGCI&S) for April-November 2001 show that exports at US $ 28.9 billion increased by 0.5 per cent as against an increase of 21.0 per cent during the comparable period of the previous year (Table 1.11).

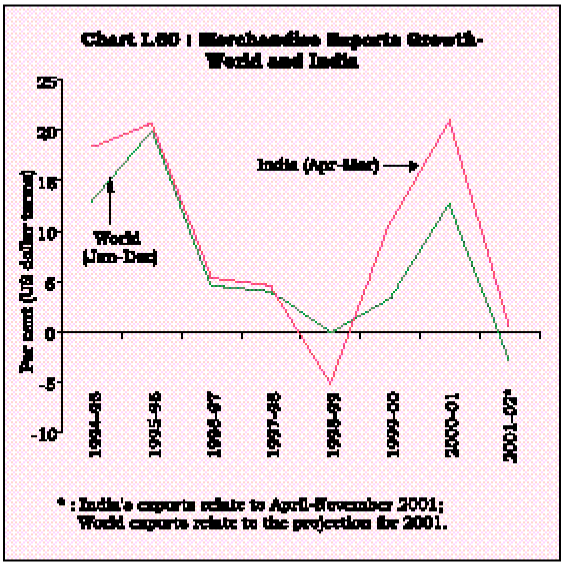


Table 1.11: India's Foreign Trade

(US $ Million)

Item	1999-2000	2000-01	2000-01*	2001-02*
	(April-March)		(April-November)	
1	2	3	4	5

Exports	36,822	44,560	28,729	28,864
	(10.8)	(21.0)	(21.0)	(0.5)
(a) Oil	39	1,870	993	1,443
	(-56.5)	(4709.7)	(3205.2)	(45.2)
(b) Non-Oil	36,784	42,691	27,735	27,421
	(11.0)	(16.1)	(17.0)	(-1.1)
Imports	49,671	50,536	34,317	34,718
	(17.2)	(1.7)	(7.4)	(1.2)
(a) Oil	12,611	15,650	11,361	9,844
	(97.1)	(24.1)	(71.3)	(-13.4)
(b) Non-Oil	37,059	34,886	22,956	24,874
	(3.0)	(-5.9)	(-9.3)	(8.4)
Trade Balance	-12,848	-5,976	-5,588	-5,854
(a) Oil	-12,573	-13,780	-10,368	-8,401
(b) Non-Oil	-276	7,804	4,779	2,547

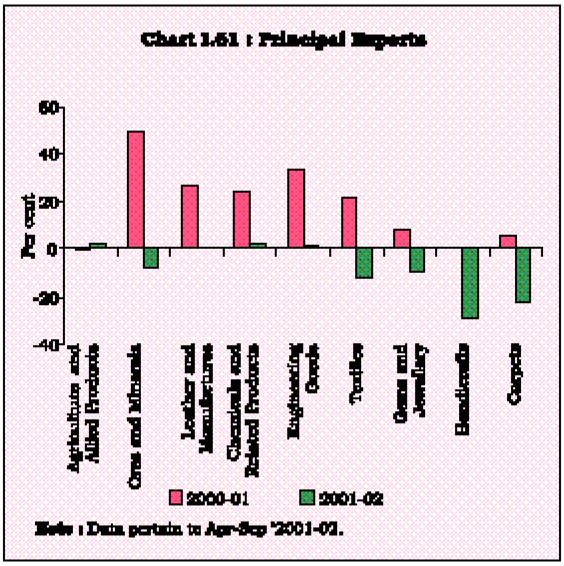
* Provisional

Note :Figures in brackets relate to percentage variation over the corresponding period of the previous year.

Source :DGCI & S.

1.93 Imports at US $ 34.7 billion during April-November 2001 showed a lower order of increase of 1.2 per cent as compared with that of 7.4 per cent during the corresponding period of the previous year, reflecting the decline in oil imports (13.4 per cent) as also the subdued overall domestic demand. The trade deficit increased to over US $ 5.8 billion during April-November 2001 from that of about US $ 5.6 billion during the corresponding period of the previous year.

1.94 Detailed commodity/country-wise trade data are available only for the period April-September 2001. Although a general decline in the exports was observed across most of the commodity-groups, some of the major groups such as 'agriculture & allied products', 'chemicals and related products', and 'engineering goods' recorded positive growth (Chart I.61 and Table 1.12).



1.95 Destination-wise data on exports clearly brings out the role of external demand in shaping

India's export performance. Given the severe recession in several advanced economies, India's exports to the OECD group declined by 12.6 per cent during April-September 2001 as against an increase of 16.9 per cent recorded during the corresponding period of the previous year. Within the OECD group, exports to the USA and Japan fell by 15.1 per cent and 16.3 per cent, respectively, during April-September 2001.

Table 1.12 :Growth Rates of India’s Principal Exports

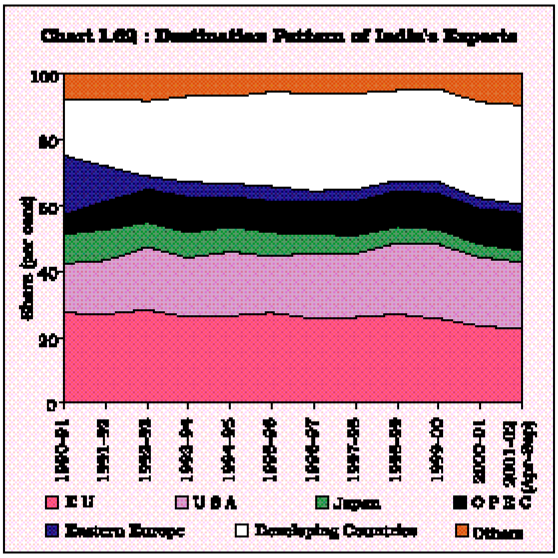
(Per cent)

Item	(April-March)		(April-September)	
	1999-00	2000-01P	2000-01	2001-02P
1	2	3	4	5
I. Primary Products	**-5.8**	**9.8**	**5.6**	**0.1**
(a) Agriculture and Allied Products	-7.1	7.0	-0.7	1.7
(b) Ores and Minerals	2.5	26.4	49.4	-7.5
II. Manufactured Goods	**15.2**	**16.1**	**20.5**	**-6.4**
of which:				
(a) Leather and Manufactures	-4.2	22.7	27.2	-0.1
(b) Chemicals and Related Products	17.4	25.1	24.0	2.5
(c) Engineering Goods	15.4	33.2	33.8	1.3
(d) Textiles	9.9	17.9	21.9	-12.4
(e) Handicrafts	5.6	0.0	0.5	-28.7
(f) Gems and jewellery	26.5	-1.5	8.3	-9.4
(g) Carpets	18.7	-9.8	5.7	-22.3
III. Petroleum Products	**-56.5**	**4709.7**	**1814.8**	**89.7**
Total Exports	**10.8**	**21.0**	**21.2**	**-2.0**

P :Provisional

Source :DGCI & S.

Exports to Eastern Europe also declined by 6.1 per cent during this period. Exports to other regions, however, showed positive growth. Exports to the developing countries, which have gained considerable prominence over the years as a destination of India's exports, recorded a growth of 7.6 per cent during April-September 2001 (Chart I.62). The growth rates of exports to some of the Asian countries showed sharp improvement during April-September 2001 *vis-a-vis* the corresponding period of the previous year.



1.96 Commodity-wise data on imports reveal that the overall 2.0 per cent increase in imports during April-September 2001 was mainly on account of the sharp 22.2 per cent increase in the imports of gold and silver, which accounted for as much as 10.1 per cent of total imports during this period. Non-oil imports, excluding gold and silver, increased by 4.2 per cent during this period. Among the major import items, sharp declines occurred in respect of cashew nuts (67.1 per cent), 'pearls, precious and semi-precious stones' (16.7 per cent) and fertilisers (18.1 per cent). The imports of some of the industry-related items, however, showed sharp increases; 'metalliferrous ores and metal scraps' (60.9 per cent), 'electrical machinery except electronics' (40.8 per cent), 'textile yarn, fabrics etc.' (28.3 per cent), 'non-metallic mineral products' (27.0 per cent), and 'chemical materials and products' (24.1 per cent). The import of bulk consumption goods rose by 36.9 per cent, mainly on account of the substantial increase in the import of pulses (550.8 per cent) reflecting the shortfall in domestic production *vis-a-vis* growing demand (Chart I.63 and Table 1.13).

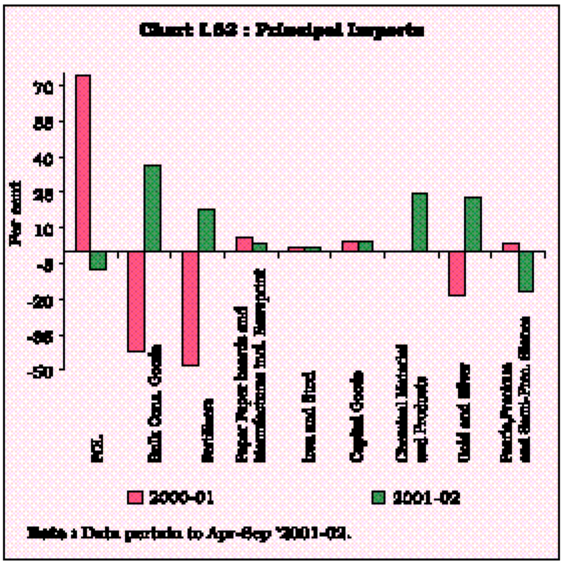


Table 1.13: Growth Rates of India's Principal Imports

(Per cent)

Item		April-March		April-September	
		1999-00	2000-01*	2000-01	2001-02*
	1	2	3	4	5
1.	Petroleum, Crude and Products	97.1	24.1	74.6	-7.1
2.	Bulk Consumption Goods	-4.3	-40.7	-42.4	36.9
3.	Fertilisers	30.0	-46.7	-48.4	-18.1
4.	Non-Ferrous Metals	-8.5	-3.8	6.5	17.6
5.	Paper, Paperboards, Manufactures including Newsprint	-3.8	0.7	5.7	3.1
6.	Crude Rubber including Synthetic and Reclaimed	-1.5	5.4	24.2	6.8
7.	Pulp and Waste Paper	8.3	9.3	9.8	-5.6
8.	Metalliferrous Ores and Metal Scrap	20.8	-14.3	-3.9	60.9
9.	Iron and Steel	-10.5	-18.7	2.0	2.1
10.	Capital Goods	-10.9	-2.0	4.1	3.8
11.	Pearls, Precious and Semi-Precious Stones	44.6	-11.5	3.4	-16.7
12.	Chemicals, Organic and Inorganic	6.8	-14.9	-9.9	6.5
13.	Textile Yarn, Fabrics, *etc.*	17.9	10.8	36.4	28.3
14.	Cashew Nuts, Raw	20.1	-23.8	-0.9	-67.1
15.	Gold and Silver	-7.2	-5.9	-18.9	22.2
16.	Artificial Resins and Plastic Materials	6.5	-23.0	-21.4	5.2
17.	Coal, Coke and Briquittes *etc.*	2.9	9.4	20.8	-3.1
18.	Medicinal and Pharmaceutical Products	-2.9	-0.1	-0.4	0.5
19.	Chemical Materials and Products	-7.4	-8.7	-0.8	24.1
20.	Non-Metallic Mineral Manufactures	2.2	5.3	11.6	27.0
Total Imports		**17.2**	**1.7**	**11.0**	**2.0**

* : Provisional

Source : DGCI & S.

1.97 The recently concluded Ministerial Conference of the World Trade Organisation (WTO) at Doha represents a major landmark in the progress towards equitable and multilateral rules for international trade. The deliberations of the Conference are expected to have important implications for developing countries including India (Box I.1).

1.98 Invisible earnings continued to provide significant support to India's balance of payments during the first half of 2001-02, though such earnings in net terms were marginally lower at US $ 5.3 billion during April-September 2001 as compared with US $ 5.6 billion during the corresponding period of the previous year. Private transfers from nonresident Indians were at US $ 5.9 billion as against US $ 6.7 billion in April-September 2000. Software exports rose by about 16.1 per cent to US $ 3.6 billion from US $ 3.1 billion in the first half of 2000-01. The sizeable increase in earnings from communication services, construction services, financial services, software services, management services *etc.*, however, was partly offset by higher payments on account of financial services, management services, office maintenance, royalties, license fees *etc.*, resulting in a lower net miscellaneous earnings to the tune of US $ 705 million during April-September, 2001 as compared with US $ 1,341 million during the corresponding period in the previous year (Table 1.14).

Box I.1

The Doha Ministerial Conference - An Indian Perspective

The Fourth Ministerial Conference of the World Trade Organisation (WTO), took place during November 9-14, 2001 at Doha, Qatar. During the run-up to the Conference and during the actual deliberations at Doha, India's stand on the principal issues was:

- ? The high level of protection provided to trade in agriculture by many developed countries be removed as they hurt the farm exports of developing countries. Adequate flexibility should also be provided to developing countries to take care of their concerns relating to food and livelihood security and rural development.
- ? Implementation issues of concern to the developing countries be satisfactorily addressed and non-trade related issues to be kept out of the agenda for negotiation.
- ? New issues (or Singapore issues) like investment, competition policy, trade facilitation and transparency in government procurement should not be brought under the fold of the WTO.
- ? India opposed the broadening of the jurisdiction of the WTO on issues relating to trade and labour standards and trade and environment. According to India, the existing WTO rules are adequate to deal with all legitimate environment issues.
- ? The TRIPs Agreement to be interpreted and implemented in a manner supportive of WTO member's right to protect public health and ensure access to medicines for all. WTO provisions on geographical indications for wines and spirits should be extended to other products and there should not be any misuse of the biological and genetic resources and traditional knowledge of the developing countries.
- ? The development deficit in various WTO Agreements to be recognised and necessary remedial action taken.
- ? Regarding market access, the issue of significant trade barriers in the form of tariff peaks and tariff escalation in the industrialised countries to be addressed as it affects exports of many developing countries.

The Doha Ministerial Declaration explicitly recognised that for effective functioning of the WTO it is crucial to safeguard the interests of the developing and least-developed countries. The Declaration also recognised the crucial role of the special and differential treatment extended to developing and least-developed countries within the WTO framework. Agreement has been reached to strengthen such provisions for more precise, effective and operational implementation. While upholding the right of the members to take measures to protect environment, it has been emphasised that such measures should be within the scope of the existing norms of the WTO. Similarly, the Declaration took note of the work in progress at the International Labour Organisation (ILO) for implementation of the core labour norms. Explicit cognizance has been taken of the concerns of the developing countries on the implementation issues. The Declaration also calls for removal of protectionism in trade in agricultural products and at the same time, recognises the non-trade concerns of the developing countries relating to agriculture. The Declaration on TRIPs also mirrors the concerns raised by the developing countries in the context of government action for maintenance of public health, extension of the scope of norms on geographical indicators and protection of traditional knowledge.

After the next Ministerial Conference, negotiations may take place in some of the issues relating to investment, competition and transparency in government procurement on the basis of explicit consensus among the members. The Declaration states that there would be negotiations on trade and environment without prejudging the existing WTO rules and specific trade obligations set out in multilateral environmental agreements. On the basis of the recommendations of the WTO Committee on Environment, the next Ministerial Conference would decide the future action including the desirability of negotiations on trade and environment. The Declaration has resolved to maintain the customs tax-free status of electronic commerce through electronic transmission.

Some of the implementation concerns raised by India have been adequately addressed in the Doha Declaration and the remaining items have been referred either to negotiations or to subsidiary bodies for further examination. The Declaration reaffirmed that that the International Labour Organisation (ILO) is the appropriate forum to address the core labour standards. The key concerns of India in agriculture have been adequately safeguarded in the Declaration.The special and differential treatment for developing countries including recognition of food security and rural development have now become an integral part of the mandated Agricultural Negotiations. In services, the movement of natural persons has been given primary focus apart from reaffirmation of the guidelines and procedures of negotiations. On the four Singapore issues, it was decided that the study process would continue until the fifth Ministerial Conference and decision regarding any negotiation would be based on explicit consensus. Negotiations have also been mandated under the Anti-dumping and Subsidies Agreements. The various implementation proposals on these subjects will also become part of the negotiations. There is a clear commitment to review the provisions for Special and Differential treatment for developing countries in various WTO agreements to see how these provisions can be strengthened, made more precise, effective and operational.

Reference

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2. World Trade Organisation, (2001), *Preparations for the Fourth Session of the Ministerial Conference: Communication from India,* WT/GC/W/459 (November 6).
3. (2001), India: *Statement by Shri Murasoli Maran, Minister of Commerce and Industry,* WT/ MIN(01)/ST/10, (November 10).
4. (2001), Ministerial Declaration, WT/ MIN(01)/DEC/1, (November 20).

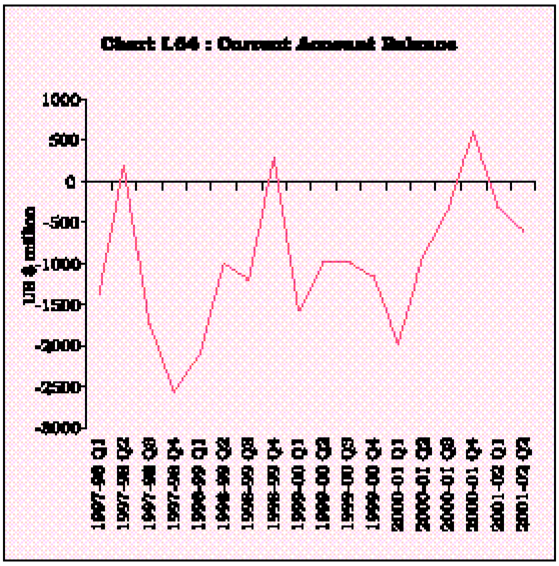
Table 1.14 :Inflows under Invisibles by Category

(US $ million)

		2000-2001	1999-2000	April-September	
				2001	2000
	1	2	3	4	5
	Invisibles (Net)	**11,791**	**13,143**	**5,316**	**5,569**
a)	**Services**	**2,478**	**4,064**	**524**	**845**
	Travel	294	897	101	50
	Transportation	-1,257	-703	-411	-748
	Insurance	135	109	19	70
	G.n.i.e	316	312	110	132
	Miscellaneous	2,990	3,449	705	1,341
b)	**Transfers**	**13,134**	**12,638**	**6,046**	**6,791**
	Official	336	382	111	122
	Private	12,798	12,256	5,935	6,669
c)	**Income**	**-3,821**	**-3,559**	**-1,254**	**-2,067**
	Investment income	-3,918	-3,695	-1,304	-2,122
	Compensation to Employees	97	136	50	55

G.n.i.e : Government not included elsewhere

1.99 The current account deficit stood at US $ 0.9 billion during the first half of 2001-02 as against US $ 2.9 billion in April-September 2000 (Chart I.64).



1.100 Capital account developments in April-October 2001 were indicative of continuing international confidence in the fundamentals of the Indian economy. Total foreign investment inflows during April-October 2001 stood at US $ 3.3 billion as against US $ 2.3 billion during the corresponding period of the previous year. Foreign direct investment (FDI) inflows during April-October 2001 were US $ 2.0 billion as compared with US $ 1.4 billion during the corresponding period of 2000-01. FII inflows amounted to US $ 0.7 billion during the first seven months (April-October) of 2001-02 as against US $ 0.2 billion during the corresponding period of 2000-01 (Table 1.15). Net inflows under NRI deposits during April-October, 2001 amounted to US $ 1.5 billion, as against US $ 1.1 billion during the corresponding period of the previous year (Chart I.65 and Table 1.16). The increase in capital inflows noticed during the first seven months of the current financial year is an encouraging development in the face of a global slowdown and subdued international capital mobility.

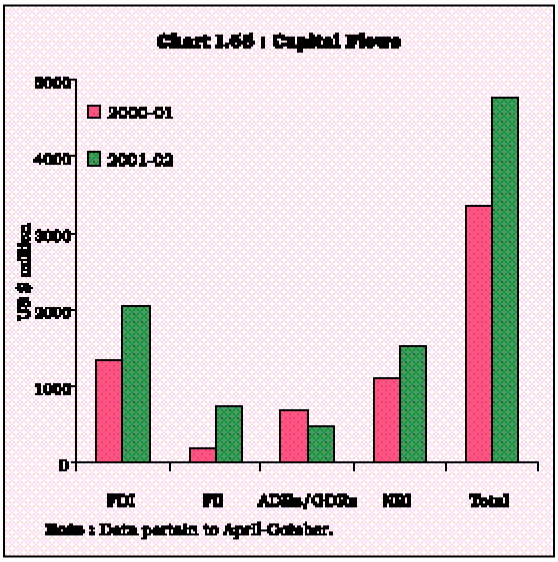


Table 1.15 : Foreign Investment Flows by Category

(US $ million)

	Item	2000-01P	1999-2000	April-October (P) 2001-02	April-October (P) 2000-01
	1	2	3	4	5
A.	Direct Investment	2,339	2,155	2,049	1,355
	a) Government (SIA/FIPB)	1,456	1,410	1,240	845
	b) RBI	454	171	501	221
	c) NRI	67	84	30	46
	d) Acquisition of shares *	362	490	278	243
B.	Portfolio Investment	2,760	3,026	1,245	959
	a) GDRs/ADRs #	831	768	477	696
	b) FIIs @	1,847	2,135	729	189
	c) Off-shore funds and others	82	123	39	74
Total	**(A+B)**	**5,099**	**5,181**	**3,294**	**2,314**

P Provisional.

* Relates to acquisition of shares of Indian companies by non-residents under Section 5 of FEMA

1999.

#	Represents the amount raised by Indian corporates through Global Depository Receipts (GDRs)/ American Depository Receipts (ADRs).
@	Represents net inflow of funds by Foreign Institutional Investors (FIIs).

India's External Debt

1.101 According to provisional data, India's external debt at US $ 98.3 billion as at the end-June 2001 declined by 2.1 per cent from US $ 100.4 billion at end-March 2001. Componentwise analysis reveals that all components of external debt, except long-term non-resident deposits declined during the the first quarter of 2001-02. The consolidation of external debt was carried further during the quarter as indicated by key indicators of debt sustainability.

Table 1.16 : Inflows under NRI Deposit Schemes

(US $ million)

Scheme		Variation @			
				April-October (P)	
		2000-01	1999-2000	2001-02	2000-01
1		2	3	4	5
1.	FCNR(B)	904	337	387	166
2.	NR(E)RA	860	885	780	569
3.	NR(NR)RD	553	318	355	390
Total		**2,317**	**1,540**	**1,522**	**1,125**

P Provisional.

@ All the figures are inclusive of accrued interest and valuation arising on account of fluctuations in non-dollar currencies against the US dollar.

The concessional debt as a proportion to total debt continued to be significant with a marginal increase to 36.5 per cent at end-June 2001 from 35.9 per cent at end-March 2001. The size of short-term debt remained modest both in regard to total debt and reserves. While the proportion of short-term to total debt declined to 3.2 per cent at end-June 2001 as against 3.4 per cent at end-March 2001; the ratio of short-term debt to foreign exchange reserves declined significantly from 8.2 per cent at end-March 2001 to 7.2 per cent at end-June 2001. (Table 1.17)

Table 1.17: India's External Debt

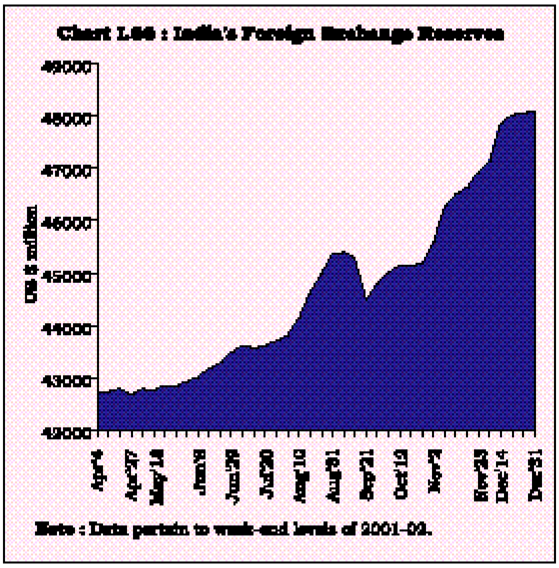
Item	At the end of				
	June 2001		March 2001		Variation during the quarter (April-June 2001) (per cent)
	Amount (US $ million)	Share in total debt	Amount (US $ million)	Share in total debt	
1	2	3	4	5	6
1. Multilateral	31,035	31.6	31,104	31.0	-0.2
2. Bilateral	15,810	16.1	16,624	16.6	-4.9
3. IMF	0	0.0	0	0.0	0
4. Commercial Borrowings (including trade credits)#	29,309	29.8	30,041	29.9	-2.4
5. NRI Deposits (long-term)	15,729	16.0	15,432	15.4	1.9

6. Rupee debt	3,230	3.3	3,693	3.7	-12.5
7. Long Term-Debt (1to 6)	95,113	96.8	96,894	96.6	-1.8
8. Short-Term Debt *	3141	3.2	3462	3.4	-9.3
9. Total Debt (7+8)	98,254	100.0	100,356	100.0	-2.1

\# Includes net investment by 100 % FII debt funds.

* Excludes suppliers' credit of up to 180 days.

1.102 During the year 2001-02 (April-December), there has been an accumulation of foreign exchange reserves of the order of US $ 5.8 billion. As a result, India's foreign exchange reserves increased from US $ 42.3 billion as at end-March 2001 to US $ 48.1 billion as at the end of December 2001 (Chart I.66).



The import cover of reserves improved from 8.6 months of imports at the end of March, 2001 to around 10 months of imports at the end of December 2001. The overall approach to the management of India's foreign exchange reserves in recent years has reflected the changing composition of balance of payments, and has endeavoured to reflect the "liquidity risks" associated with different types of flows and other requirements. The policy for reserve management is thus judiciously built upon a host of identifiable factors and other contingencies. Taking these factors into account, India's foreign exchange reserves are at present comfortable.

[1] AL = Reserve Bank's net claims on the Government (adjusted for net open market (including repo) operations) + Claims on banks (other than credit to scheduled commercial banks) + Credit to the commercial sector (other than credit to PDs) + Net foreign assets – Notes in circulation – 'Other' deposits – Net non-monetary liabilities, in flow terms.

DL = Net open market (including repo) operations + Credit to scheduled commercial banks and primary dealers netted for cumulative changes in reserve requirements, in flow terms.