I. Growth, Saving and Investment

Growth Rates

The Central Statistical Organisation (CSO) has placed real GDP growth in 2003-04 at 8.1 per cent and revised its previous estimates for 2002-03 downwards to 4.0 per cent from 4.3 per cent. In 2002-03, the decline in real GDP originating in 'agriculture and allied activities' was more pronounced at (–)5.2 per cent than the earlier estimate of (–)3.2 per cent. The good monsoon in 2003, coupled with the base effect of this downward revision, produced a strong rebound in agricultural growth in 2003-04. Real GDP growth originating in 'agriculture and allied activities' is estimated at 9.1 per cent, the highest since 1988-89. Industrial performance improved steadily, led by manufacturing activity. The growth of real GDP originating in services is expected to have crossed the decennial average (7.5 per cent) in 2003-04 (Table 1). Activity in 'trade, hotels, restaurants, transport and communication' is estimated to have risen by close to 11 per cent in 2003-04, 2.5 percentage points above the decennial average.

With the robust macroeconomic performance of 2003-04, the Indian economy broke free of the adversities that had beset it in 2002-03. The overall real GDP growth in 2003-04 was the highest since 1991-92 and India turned out to be one of the fastest growing economies of the world. The buoyant, all-round revitalisation of growth places the economy within striking range of the Tenth Plan projection of 8 per cent to be achieved over the period 2002-07.

Table 1: Sectoral Growth Rates of Real GDP

(Per cent)

Sector	Average 1992-93 to 2001-02	2002-03*	2003-04#	2002-03 Q1	2002-03 Q2	2002-03 Q3	2002-03 Q4	2003-04 Q1	2003-04 Q2	2003-04 Q3
1	2	3	4	5	6	7	8	9	10	11
1. Agriculture & Allied Activities	**3.4** (27.5)	**-5.2** (22.0)	**9.1** (22.2)	**0.6**	**-2.9**	**-9.8**	**-2.8**	**1.7**	**7.4**	**16.9**
a. Agriculture	3.5	-6.0	n.a.							
2. Industry	**6.3** (22.0)	**6.2** (22.0)	**6.6** (21.7)	**4.8**	**6.7**	**6.7**	**6.2**	**5.8**	**6.3**	**6.8**
a. Mining and Quarrying	3.9	8.8	4.0	11.8	10.1	7.6	3.2	3.1	2.2	4.2
b. Manufacturing	6.8	6.2	7.1	4.0	6.7	6.9	7.1	6.4	7.3	7.4
c. Electricity, Gas and Water Supply	5.6	3.8	5.4	4.3	3.9	4.8	2.4	4.8	2.9	5.2
3. Services	**7.5** (50.5)	**7.2** (56.1)	**8.2** (56.1)	**7.2**	**7.9**	**6.8**	**7.5**	**7.4**	**9.5**	**8.7**
a. Trade, Hotels, Restaurants, Transport and Communication	8.4	7.0	10.9	6.4	7.4	6.5	8.8	9.6	11.7	13.1
b. Financing, Insurance, Real Estate and Business services	7.8	8.8	6.4	9.6	9.8	8.6	4.4	7.1	7.3	7.7
c. Community, Social and Personal services	7.1	5.8	5.9	6.2	6.4	5.6	7.7	4.2	8.9	2.8
d. Construction	5.2	7.3	6.0	7.1	9.5	7.4	7.5	5.7	6.4	5.1
4. GDP at factor cost	**6.1**	**4.0**	**8.1**	**5.1**	**5.5**	**2.0**	**4.9**	**5.7**	**8.4**	**10.4**

*: Quick Estimates; #: Advance Estimates; n.a.: Not available.

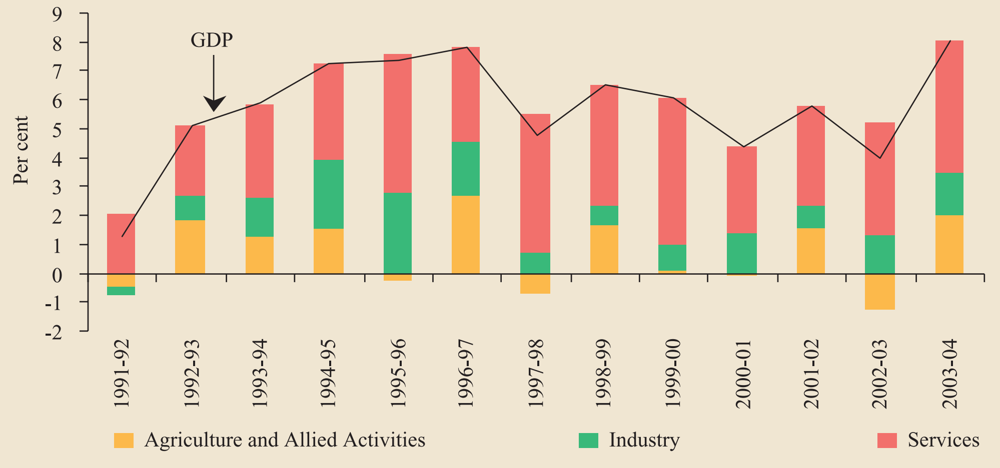
Notes: 1. Figures in the brackets denote shares in real GDP.

2. Q1: First Quarter (April June); Q2: Second Quarter (July-September); Q3: Third Quarter (October-December); Q4: Fourth Quarter (January-March).

A sharp acceleration of real GDP commenced from the second quarter, strengthening to reach double-digits in the third quarter of 2003-04. Agriculture led the resurgence on the strength of a record *kharif* output which was reinforced in the second half of the year by a bumper *rabi* crop. Growth in manufacturing gained in each successive quarter, drawing from the revival of rural demand and exports. The overall expansion of the services sector was mainly driven by 'trade, hotels, restaurants, transport and communication'. The acceleration in this segment and a steady improvement in performance of 'finance, insurance, real estate and business services' took real GDP growth originating in the services sector to 8.7 per cent in the third quarter.

The services sector remained the principal driver of the Indian economy, contributing 57 per cent of the growth of real GDP in 2003-04. 'Agriculture and allied activities' contributed 25 per cent of real GDP growth, compensating for the negative contribution of 31 per cent witnessed in 2002-03. On the other hand, industry's contribution to growth declined to 18 per cent in 2003-04 from 34 per cent in the preceding year (Chart 1). The share of services in GDP has risen steadily from 47.5 per cent in 1992-93 to 56.1 per cent in 2003-04. The share of 'agriculture and allied activities' has declined from 31.5 per cent of GDP in 1992-93 to 22.2 per cent in 2003-04. The share of industry has remained broadly unchanged at 21-22 per cent. The shifts in sectoral shares reflect the longer-term structural changes that are transforming the Indian economy.

Chart 1 : Sectoral Contributions to Real GDP Growth



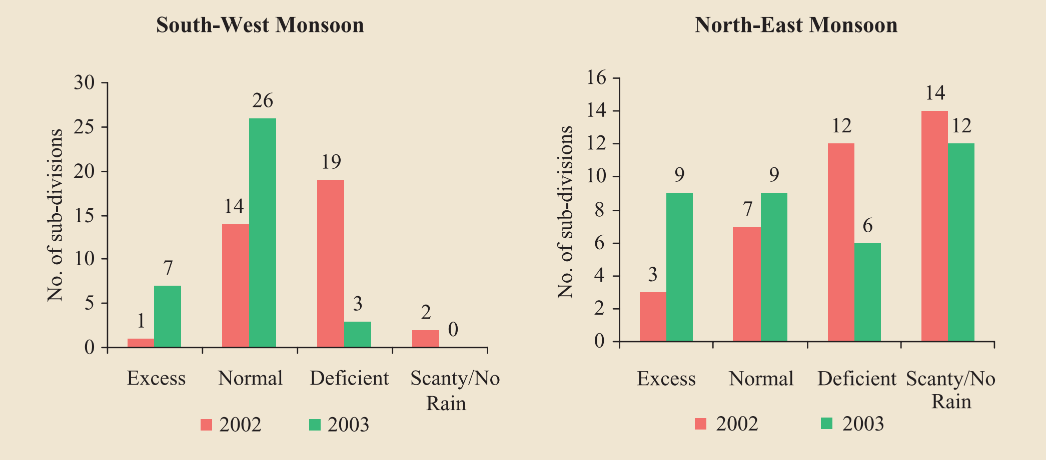
The underlying shifts in the production structure of the economy are reinforcing the leading role of services in the Indian economy. Boosting growth in 'trade, hotels, restaurants, transport and communication' is the expansion in new subscribers in cellular services, upsurge in tourist arrivals and higher occupancy of hotels. According to the CSO, net tonne kilometres and passenger kilometres in respect of railways grew by 5.5 per cent and 3.7 per cent, respectively, during the first three quarters of 2003-04. Production of commercial vehicles and cargo handled at major ports showed a growth of 35.7 per cent and 7.5 per cent, respectively.

The buoyancy in the services sector reflects its increasing synergies with the commodity producing sectors, demand for consumer services and external demand for a wide spectrum of knowledge-based services. Information technology (IT) services contribute more than three per cent of GDP. The ITES (IT Enabled Services)/ business process outsourcing (BPO) segments have witnessed high growth in recent years, especially in the form of services exports. The sector has benefited from a major rise in new investments during 2003-04, with Indian companies consolidating their presence in segments such as customer care and administration. According to the National Association of Software and Service Companies (NASSCOM), BPO is likely to have grown by 50 per cent during 2003-04.

Agricultural Situation

Moisture conditions turned favourable for a reinvigoration of agricultural activity in 2003-04. The cumulative rainfall recorded during the South-West monsoon was two per cent above the Long Period Average (LPA) with 33 out of the 36 meteorological sub-divisions receiving normal/excess rainfall. Only three sub-divisions, *viz.*, north and south interior Karnataka and Kerala received deficient rains. Fortuitously, rainfall in the sowing months of June and July 2003 was at 109 per cent and 107 per cent, respectively, of the LPA. The North-East monsoon was normal with the cumulative rainfall at nine per cent above the LPA. Normal/excess rainfall was received in 18 sub-divisions (10 in the corresponding period of 2002-03) while deficient/scanty/no rains occurred in the rest of the sub-divisions (Chart 2).

Chart 2 : Rainfall



The live water storage in the major reservoirs was 23 per cent of the Full Reservoir Level (FRL) on March 19, 2004, which was 115 per cent of the preceding year's level and 76 per cent of the decennial average. Despite the congenial conditions of water availability, a worrisome feature was the prevalence of localised droughts. In 2003-04, as many as 62 out of the 267 drought affected meteorological districts in 2002-03 continued to experience acute moisture stress. These areas were spread across Karnataka (16 districts), Tamil Nadu (nine districts), Kerala (seven districts), Punjab (five districts) and Maharashtra (four districts).

According to the Second Advance Estimates of the Ministry of Agriculture (February 16, 2004), foodgrains production is expected to have recorded a growth of 22 per cent to touch an all-time high of 212.2 million tonnes in 2003-04. Oilseeds output is estimated to have grown by over 60 per cent to scale a new peak. Cotton production is estimated to have risen by around 43 per cent, although it would still be lower than the peak of 14.2 million bales achieved in 1996-97. On the other hand, sugarcane production is expected to have declined by nine per cent mainly due to pest attack and localised drought in some of the major sugarcane growing areas. The Index of Agricultural Production (all crops) is, thus, expected to have gone up by 19.6 per cent in 2003-04 as against (-) 15.2 per cent recorded in 2002-03.

An across-the-board increase enabled the *kharif* foodgrains production to touch the target of 111 million tonnes set for 2003-04 (Table 2), up by 23 million tonnes from

Table 2 : Agricultural Production

Crop	Season	2002-03 Target (million tonnes)	2002-03 Achievement $ (million tonnes)	2002-03 Area Coverage (% of normal area)	2003-04 Target (million tonnes)	2003-04 Achievement $$ (million tonnes)	2003-04 Area Coverage (% of normal area(@
1	2	3	4	5	6	7	8
Rice	*Kharif*	78.6	63.7	78.0	78.6	77.8	87.0
	Rabi	14.4	9.0	90.0	14.4	10.1	92.0
	Total	93.0	72.7	93.0	93.0	87.9	n.a.
Wheat	*Rabi*	78.0	65.1	94.0	78.0	76.1	103.0
Coarse Cereals	*Kharif*	25.8	20.0	86.0	27.0	27.7	99.0
	Rabi	7.6	5.3	103.0	7.0	6.0	105.0
	Total	33.0	25.3	15.0	34.0	33.7	n.a.
Pulses	*Kharif*	6.0	4.1	95.0	6.0	5.4	117.0
	Rabi	10.0	7.0	117.0	9.0	9.0	141.0
	Total	16.0	11.0	n.a.	15.0	14.4	n.a.
Foodgrains	***Kharif***	**110.5**	**87.8**	**n.a.**	**111.4**	**111.0**	**n.a.**
	Rabi	**109.5**	**86.4**	**100.0**	**108.3**	**101.2**	**111.0**
	Total	**220.0**	**174.2**	**n.a.**	**220.0**	**212.2**	**n.a.**
Oilseeds	*Kharif*	15.9	9.1	88.0	14.7	16.7	100.0
	Rabi	11.1	6.0	108.0	10.0	8.3	125.0
	Total	27.0	15.6	24.7	24.7	25.0	n.a.
Sugarcane	Total	320.0	281.6	102.0	320.0	255.5	95.0
Cotton #	Total	15.0	8.7	80.0	15.0	12.4	84.0
Jute and Mesta ##	Total	12.0	11.4	90.0*	12.0	11.6	88.0*

$: Final Estimates; $$: Second Advance Estimates as on February 16, 2004; n.a.: not available.
#: Million bales of 170 kgs each; ## Million bales of 180 kgs each.
*: Pertains to Jute only. @ Area coverage is as on September 22, 2003 for *kharif* and as on April 12, 2004 for *rabi*.

the level in 2002-03. Oilseeds production, in particular, is expected to have risen by about 84 per cent during *kharif* 2003-04. *Rabi* foodgrains production is also expected to be close to the target and higher by 17.2 per cent than the level in 2002-03. Wheat production is expected to have risen by 17 per cent and oilseeds production (*rabi*) by about 38 per cent. The favourable prospects for the *rabi* output emanated from the delayed withdrawal of the South-West monsoon, the subsequent moderate temperature in the north followed by a normal North-East monsoon. These conducive conditions resulted in an improvement in area coverage under major crops.

The stocks of foodgrains with the Food Corporation of India and State-level agencies were drawn down from the peak level of 64.8 million tonnes on June 1, 2002 to 22.8 million tonnes (13.6 million tonnes of rice, 8.6 million tonnes of wheat and 0.6 million tonnes of coarse grains) as on March 1, 2004. The foodgrains stocks, however, still remain above the norm (16.8 million tonnes) to be maintained as on January 1 as well as on April 1 (15.6 million tonnes).

The steep decline in the stocks was on account of lower procurement of wheat during the *rabi* marketing season of 2002-03 and 2003-04. Paddy procurement was lower during the *kharif* marketing season of 2002-03 (by 26 per cent), but higher (by about 33 per cent) during the *kharif* marketing season of 2003-04 (October 1, 2003 to April 26, 2004). The off-take of foodgrains during 2003-04 (April to end-February) was higher under the Targeted Production Distribution System (TPDS) (by 13 per cent) and other welfare schemes (OWS) (by 28 per cent) than in the preceding year; on the other hand, off-take under open market sales (OMS) declined (by 34 per cent) (Table 3).

Table 3 : Management of Food Stocks

(Million tonnes)

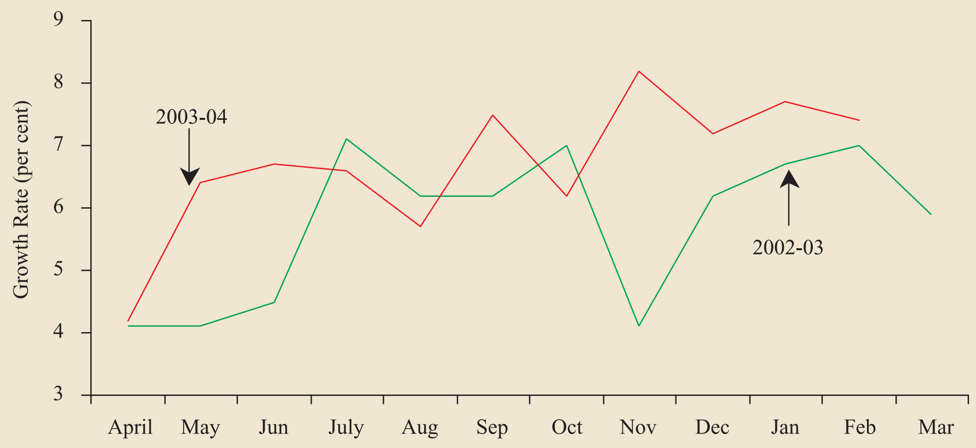
Month	Opening Stock of Foodgrains	Procurement	Off-take				Closing Stock	Norm*
			PDS	OWS	OMS	Exports		
1	2	3	4	5	6	7	8	9
2003								
April	32.8	13.1	1.6	0.9	0.2	0.8	41.3	15.6
May	41.3	3.6	2.0	1.6	0.1	0.9	39.8	
June	39.8	1.0	1.5	2.5	0.2	1.3	35.2	
July	35.2	0.2	2.2	1.4	0.1	2.2	30.5	24.3
August	30.5	0.2	1.8	0.8	0.1	0.9	27.9	
September	27.9	0.2	2.2	1.0	0.1	0.9	23.7	
October	23.7	7.2	1.8	0.7	0.1	0.9	22.1	18.1
November	22.1	1.6	1.9	0.7	0.1	0.6	25.4	
December	25.4	2.9	1.7	0.7	0.2	0.5	25.0	
2004								
January	25.0	2.3	2.2	0.9	0.2	0.4	24.0	16.8
February	24.0	2.6	1.7	1.1	0.1	0.5	22.8	
March	22.8	2.1	n.a.	n.a.	n.a.	n.a.	n.a.	
April @	n.a.	5.1	n.a.	n.a.	n.a.	n.a.	n.a.	15.6

PDS: Public Distribution System; OWS: Other Welfare Schemes; OMS: Open Market Sales (domestic).
n.a : not available; @ : Up to April 19, 2004
* : Minimum stocks to be maintained as on April 1, July 1, October 1 and January 1.
Note: Closing stocks include coarse grains.

Industrial Performance

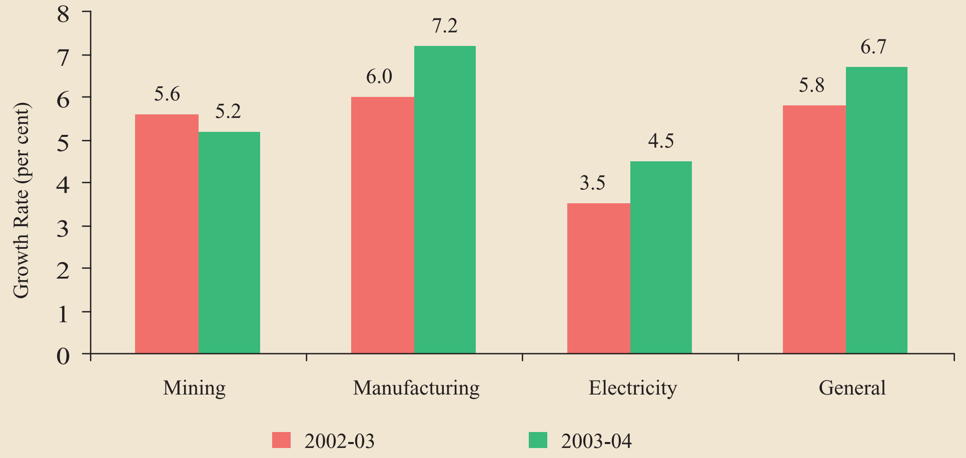
The strengthening of industrial growth in India was broad-based and occurred in an environment of accelerating industrial activity in various parts of the world, especially in East Asian economies. External demand embodied in exports provided a boost to a spectrum of manufacturing industries, supported by improvement in domestic demand conditions and reductions in excise duties on a host of intermediate inputs.

Chart 3 : Growth of Index of Industrial Production



The CSO's advance estimates indicate a distinct pick-up in the growth of real GDP originating in industry from the second quarter that was sustained in the third quarter of 2003-04. The upturn was evident as early as May 2003 in terms of the index of industrial production (IIP) (Chart 3). Over the period April 2003-February 2004, industrial production rose faster than in the preceding year on account of higher growth in the manufacturing sector (Chart 4). The CSO has placed the growth of real GDP originating in manufacturing at 7.1 per cent in 2003-04 as against 6.2 per cent in the preceding year.

Chart 4 : Index of Industrial Production (April-February)

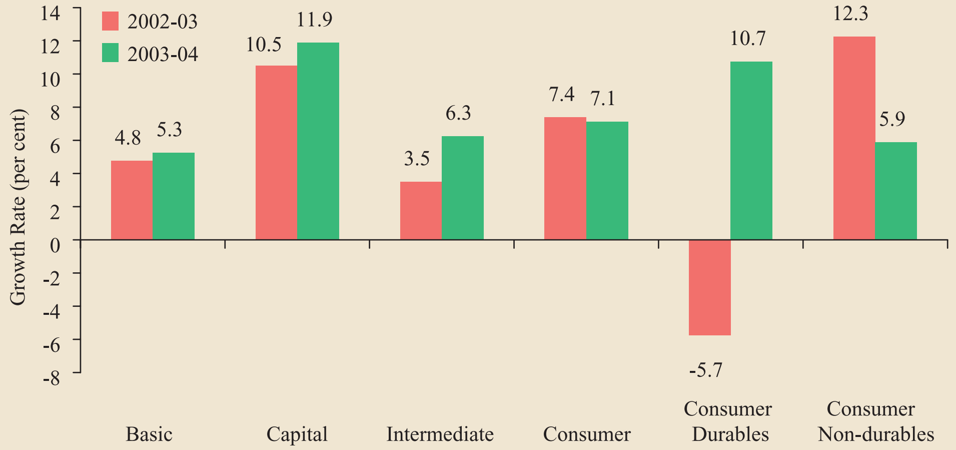


On a cumulative basis, the industrial sector recorded a higher growth during 2003-04 (up to February) as compared with the corresponding period of the previous year. Both the manufacturing and electricity sectors witnessed an acceleration in growth, while mining recorded a deceleration. The contribution of the manufacturing and electricity sectors to the overall IIP growth was also higher than in the preceding year.

In terms of the use-based classification, all sectors except consumer goods showed improved performance during 2003-04. Higher growth in the basic goods sector was on account of increased generation of electricity in hydel and thermal power plants. The higher growth in the intermediate goods sector was in consonance with the general improvement in economic activity, particularly in agriculture. The capital goods sector maintained robust growth for the second year in succession. Consumer durables showed a significant turnaround during 2003-04, facilitated by an increase in retail lending and softening of interest rates. Within the consumer goods sector, consumer non-durables recorded lower growth than in the preceding year (Chart 5).

The improvement in manufacturing activity was well distributed. Within the 17 major groups, six groups constituting a weight of 28.7 per cent in the IIP registered a growth in the range of 7.4 per cent-18.0 per cent - well above the sectoral growth of 7.2 per cent. These six industry groups comprise 'transport equipment and parts', 'basic metal and alloy industries', 'machinery and equipment other than transport equipment', 'wood and wood products', 'paper and paper products and printing, publishing & allied industries' and 'beverages, tobacco and related products'. The high growth in the transport

Chart 5 : Growth of Use-based Index of Industrial Production (April-February)



equipment sector was reflected in increased sales of cars and commercial vehicles. Higher production and import of capital goods facilitated growth in the machinery and equipment sector. These industry groups together contributed 67.9 per cent of the growth in the manufacturing sector. Seven industry groups achieved positive growth but less than the growth of manufacturing sector as a whole. On the other hand, four industry groups recorded negative growth, *viz.*, 'jute and other vegetable fibre textiles (except cotton)', 'textile products (including wearing apparel)', 'cotton textiles' and 'leather and leather & fur products' (Table 4).

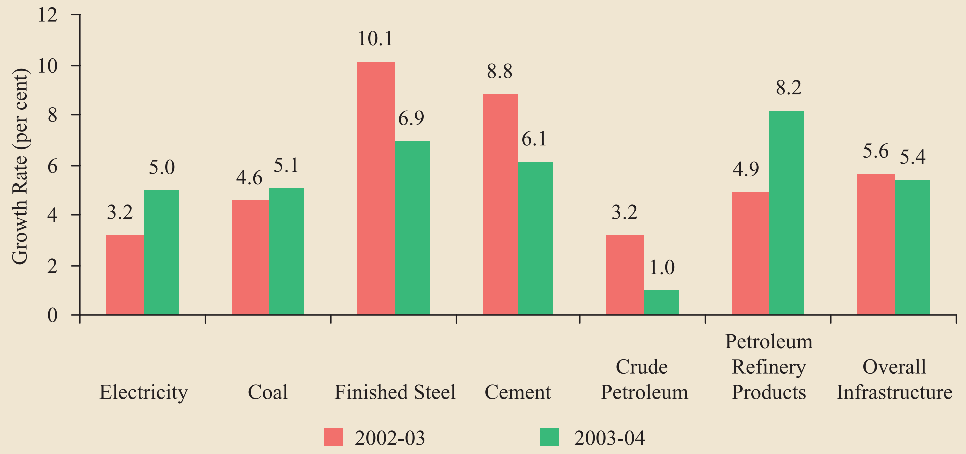
Table 4 : Industry Group Growth Rates in 2003-04 (April-February)

Negative	0-4 per cent	4-8 per cent	Above 8 per cent
1	2	3	4
1. Jute and other vegetable fibre textiles (except cotton) (-4.6)	1. Metal products and parts (except machinery and equipment) (3.5)	1. Other manufacturing industries (5.5)	1. Paper & paper products and printing, publishing & allied industries (16.3)
2. Textile products (including wearing apparel) (-2.7)	2. Food products (1.8)	2. Non-metallic mineral products (4.2)	2. Transport equipment and parts (17.9)
3. Leather and leather & fur products (-3.3)		3. Rubber, plastic, petroleum and coal products (5.5)	3. Basic metal and alloy industries (9.8)
4. Cotton textiles (-4.1)		4. Basic chemicals & chemical products (except production of petroleum & coal) (7.1)	4. Beverages, tobacco and related products (8.4)
		5. Wood and wood products, furniture & fixtures (7.4)	5. Machinery and equipment other than transport equipment (13.8)
		6. Wool, silk and man-made fibre textiles (5.0)	

Note: Figures in brackets are growth rates.

The performance of the infrastructure industries was generally lacklustre in 2003-04 with some improvement during February and March 2004. Crude petroleum was adversely affected on account of high water - oil ratio in some of the oil fields up to September 2003. Cement production slowed down on account of less than expected demand in the post-monsoon period. The increased prices of raw materials and other costs adversely affected steel production in 2003-04 (Chart 6).

Chart 6 : Infrastructure Industries



Indications of an improvement in the investment climate are getting clearer and a robust business optimism is permeating the Indian industry. Banks' non-food credit off-take has picked up since the second half of 2003-04. Sanctions and disbursements by the All India Financial Institutions (AIFIs) were substantially higher. External capital flows have been of an unprecedented order. The buoyant performance of the private corporate business sector is reflected in marked and successive increases in growth of sales and profits. The corporate sector also experienced a steady decline in interest payments (Chart 7).

The continued buoyancy of the capital goods sector augurs well for industrial performance in future. The outlook for industry has improved considerably. The business expectations survey of the National Council of Applied Economic Research (NCAER) indicates a better outlook. The business confidence index shows a rise by 6.7 per cent in January-June 2004 over October 2003 - March 2004, reflecting the buoyant corporate results and a stable global environment. The Indian Leading Index of the Delhi School of Economics-Economic Cycle Research Institute (DSE-ECRI) released in March 2004, has also shown continued optimism. A majority of respondents in the business outlook survey of the Confederation of Indian Industry (CII) for October-March 2004 expected capacity utilisation in the range of 75-100 per cent with no change in inventory levels and increase in profit margins.

Chart 7 : Growth of Select Indicators of Corporate Performance

Note: Based on a sample of around 1,200 non-Government non-financial companies.

Saving and Investment

The latest estimates for saving and capital formation pertain to 2002-03. The CSO's quick estimates indicate that the rate of Gross Domestic Saving (GDS) rose to 24.2 per cent of GDP at current market prices in 2002-03, entirely due to reduction in the public sector's dis-saving (Chart 8). Households - the mainstay of overall saving in the economy - recorded a decline in terms of financial saving which, in turn, marginally reduced the rate of household sector saving. There was also a marginal decline in the rate of private corporate sector saving in 2002-03 (Table 5).

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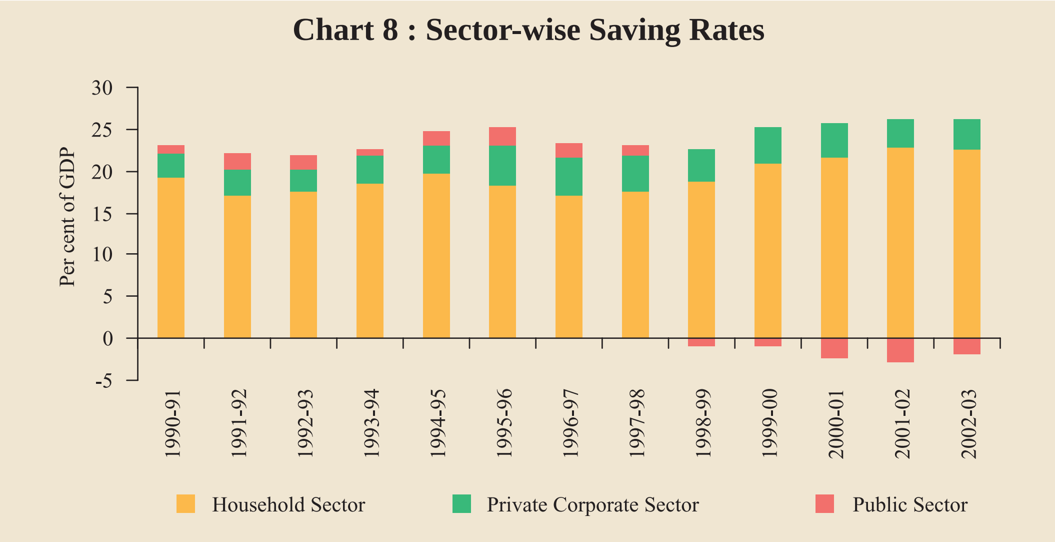

The rate of Gross Domestic Capital Formation (GDCF) increased from 23.1 per cent of GDP in 2001-02 to 23.3 per cent in 2002-03 solely because of the increase in the rate of investment of the household sector. Total consumption expenditure declined to 76.9 per cent of GDP in 2002-03 owing to a fall in private final consumption expenditure. Government final consumption expenditure, on the other hand, remained unchanged in relation to GDP.

Table 5 : Gross Domestic Saving and Investment

Item	Per cent of GDP**				Amount in Rupees crore			
	1999-00	2000-01	2001-02@	2002-03*	1999-00	2000-01	2001-02@	2002-03*
1	2	3	4	5	6	7	8	9
1. Household Sector Saving	20.8	21.7	22.7	22.6	4,02,360	4,53,641	5,19,040	5,59,258
a. Financial Assets	10.5	10.4	11.1	10.3	2,03,702	2,17,841	2,54,304	2,54,407
b. Physical Assets	10.3	11.3	11.6	12.3	1,98,658	2,35,800	2,64,736	3,04,851
2. Private Corporate Sector Saving	4.4	4.1	3.5	3.4	84,329	86,142	78,849	84,169
3. Public Sector Saving	-1.0	-2.3	-2.7	-1.9	-20,049	-48,022	-62,704	-45,730
4. Gross Domestic Saving (GDS)	24.1	23.5	23.5	24.2	4,66,640	4,91,761	5,35,185	5,97,697
5. Net capital inflow	1.1	0.6	-0.3	-0.9	21,988	12,977	-7,268	-22,664
6. Gross Domestic Capital Formation (GDCF)	25.2	24.2	23.1	23.3	4,88,628	5,04,738	5,27,917	5,75,033
7. Total Consumption Expenditure	78.6	77.7	77.9	76.9	15,22,664	16,24,255	17,78,358	18,99,959
a. Private final consumption expenditure	65.7	65.1	65.5	64.4	12,71,556	13,60,018	14,94,050	15,91,132
b. Government final consumption expenditure	13.0	12.6	12.5	12.5	2,51,109	2,64,237	2,84,308	3,08,827
Memo Items								
Saving-Investment Balance (4-6)	-1.1	-0.6	0.3	0.9	-21,988	-12,977	7,268	22,664
Public Sector Balance#	-8.0	-8.7	-8.6	-7.5	-1,54,533	-1,82,047	-1,95,707	-1,86,116
Private Sector Balance#	8.4	9.6	9.7	8.9	1,62,911	2,00,187	2,21,832	2,19,997
a. Private Corporate Sector	-2.1	-0.8	-1.4	-1.4	-40,791	-17,654	-32,472	-34,410
b. Household Sector	10.5	10.4	11.1	10.3	2,03,702	2,17,841	2,54,304	2,54,407

@ : Provisional Estimates; * : Quick Estimates; # : Investment figures are not adjusted for errors and omissions.
**: At current market prices.

Since 2001-02, the rate of GDCF has remained below the rate of GDS, as reflected in current account surpluses in the balance of payments. The overall saving-investment surplus increased in 2002-03. The public sector saving - investment gap narrowed in 2002-03, reflecting its reduced dis-saving. Households' financial saving, on the other hand, suffered a marginal erosion.

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II. Fiscal Situation

Combined Government Finances

The combined gross fiscal deficit of the Centre and States for the year 2003-04 was budgeted at 9.2 per cent of GDP, lower than 10.1 per cent in the revised estimates for 2002-03. Commensurate reductions were also envisaged in the combined gross primary deficit and the revenue deficit through higher revenue mobilisation as well as moderation in the growth of aggregate expenditure.

Centre's Fiscal Position

The Union Budget for 2003-04 accorded the highest priority to fiscal consolidation through revenue augmentation and elimination of budgetary drags. The revised estimates (RE) for 2003-04 presented in the Interim Budget for 2004-05 indicate a satisfactory outcome, with all key deficit indicators undershooting the budget estimates (BE) for the first time since 1991 (Table 6). This was a consequence of a combination of measures to enhance revenue buoyancy, contain revenue expenditure and secure higher realisation of disinvestment proceeds.

Table 6 : Deficit Indicators of the Centre

(Rupees crore)

Item	2002-03	2003-04 (BE)	2003-04 (RE)	Variation (Column 4 over Column 3)	
				Amount	Per cent
1	2	3	4	5	6
1. Gross Fiscal Deficit	1,31,306 (5.4)	1,53,637 (5.6)	1,32,103 (4.8)	-21,534	-14.0
2. Revenue Deficit	1,07,879 (4.4)	1,12,292 (4.1)	99,860 (3.6)	-12,432	-11.1
3. Gross Primary Deficit	13,502 (0.6)	30,414 (1.1)	7,548 (0.3)	-22,866	-75.2

BE: Budget Estimates. RE: Revised Estimates.
Note: Figures in brackets are proportions to GDP in per cent.

Revenue receipts were 3.6 per cent higher than their budgeted levels, buoyed by higher tax collections as well as non-tax revenues. The rise in tax revenues was essentially on account of increased corporation tax and service tax collections, reflecting improved profitability of the corporate sector. This more than offset the shortfall in both personal income tax and union excise duty *vis-a-vis* the BE (Chart 9).

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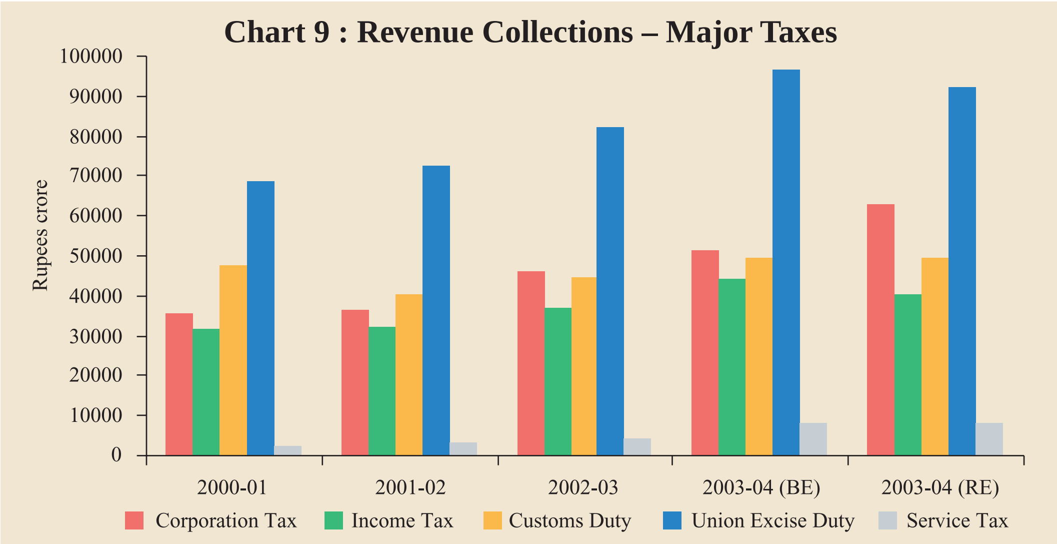


The increase in non-tax revenues over the BE was mainly due to higher dividends and profits which accounted for 73.8 per cent of the rise. Non-debt capital receipts (comprising disinvestment and recovery of loans) accounted for 37.5 per cent of total capital receipts, significantly higher than the budgeted 16.9 per cent. This was largely on account of receipts under the State Debt Swap Scheme (DSS), which enabled the States to substitute high-cost debt owed to the Central Government with market borrowings raised at relatively lower rates of interest in 2003-04 and part of current small savings transfers. All loans from the Centre to the State Governments bearing coupons in excess of 13 per cent are to be swapped at prevailing interest rates over a period of three years ending in 2004-05. As these receipts were used by the Centre to discharge its liabilities under the National Small Savings Fund (NSSF), thereby increasing its non-plan capital expenditure, transactions on account of the State DSS are deficit neutral. Net of receipts under the debt swap, non-debt capital receipts contributed 19.8 per cent of the total capital receipts (Table 7).

Aggregate expenditure was higher than the budget estimates mainly on account of debt swap transactions (Table 8). Aggregate expenditure, net of repayment to the NSSF was, however, lower than the budget estimate. Compression in expenditure was effected exclusively in the non-plan component. Of this, a reduction of Rs.4,582 crore in the revenue account was mainly on account of lower spending on subsidies. The remaining decline of Rs.7,094 crore was in the capital account, mainly in the outlay on defence. Interest

Table 7 : Total Receipts of the Centre

(Rupees crore)

Item	2002-03	2003-04 (BE)	2003-04 (RE)	Variation (4 over 3) Amount	Per cent
1	2	3	4	5	6
1. Total Receipts (2+5)	4,00,396 (16.2)	4,38,795 (16.0)	4,74,255 (17.2)	35,460	8.1
2. Revenue Receipts (3+4)	2,31,748 (9.4)	2,53,935 (9.3)	2,63,027 (9.5)	9,092	3.6
3. Tax Revenue	1,59,425 (6.5)	1,84,169 (6.7)	1,87,539 (6.8)	3,370	1.8
4. Non-Tax Revenue	72,323 (2.9)	69,766 (2.5)	75,488 (2.7)	5,722	8.2
Of which:					
Dividends and Profits	21,230	17,861	22,081	4,220	23.6
5. Capital Receipts	1,68,648 (6.8)	1,84,860 (6.7)	2,11,228 (7.7)	26,368	14.3
Of which:					
Market Borrowing	1,04,126	1,07,194	85,671	-21,523	-20.1
Recovery of Loans	34,191	18,023	64,625	46,602	258.6
Disinvestment proceeds	3,151	13,200	14,500	1,300	9.8

BE: Budget Estimates. RE: Revised Estimates.
Note: Figures in brackets are proportions to GDP in per cent.

payments (excluding pre-payment premium of Rs.4,080 crore on internal and external debt) also recorded a decline from the budgeted level, reflecting the softening of interest rates on Government securities.

Table 8 : Aggregate Expenditure of the Centre

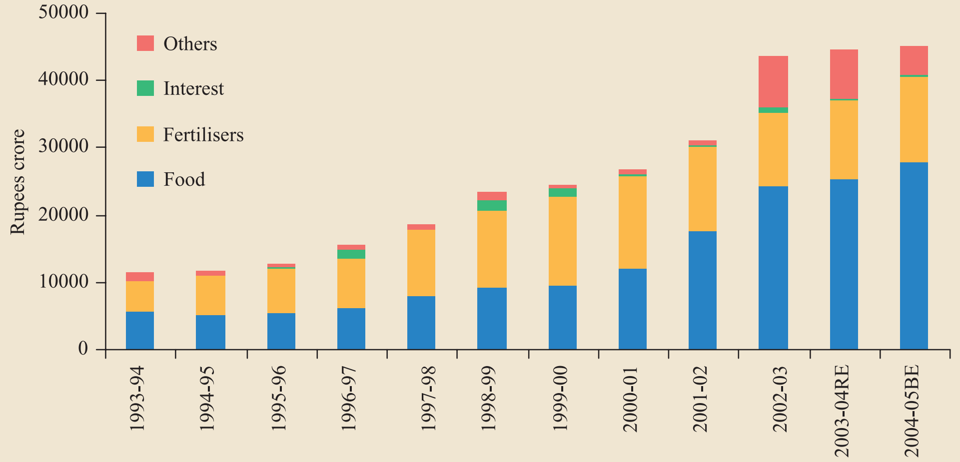
(Rupees crore)

Item	2002-03	2003-04 (BE)	2003-04 (RE)	Variation (4 over 3) Amount	Per cent
1	2	3	4	5	6
1. Total Expenditure (2+3=4+5)	4,00,397	4,38,795	4,74,255	35,460	8.1
2. Non-Plan Expenditure	2,88,942 (11.7)	3,17,821 (11.6)	3,06,145* (11.1)	-11,676	-3.7
Of which:					
Interest Payments	1,17,804 (4.8)	1,23,223 (4.5)	1,24,555# (4.5)	1,332	1.1
Defence	55,662 (2.3)	65,300 (2.4)	60,300 (2.2)	-5,000	-7.7
Subsidies	43,515 (1.8)	49,907 (1.8)	44,707 (1.6)	-5,200	-10.4
3. Plan Expenditure	1,11,455 (4.5)	1,20,974 (4.4)	1,21,507 (4.4)	533	0.4
4. Revenue Expenditure	3,39,628 (13.8)	3,66,227 (13.3)	3,62,887 (13.2)	-3,340	-0.9
5. Capital Expenditure	60,769 (2.5)	72,568 (2.6)	1,11,368 (4.0)	38,800	53.5

* Net of receipts of Rs.46,602 crore from States under the Debt Swap Scheme.
\# Includes pre-payment premium of Rs.4,080 crore.
BE: Budget Estimates. RE : Revised Estimates.
Note: Figures in brackets are proportions to GDP in per cent.

Outgo on subsidies was sharply curtailed. The expenditure on subsidies increased by only 2.7 per cent in 2003-04 as compared with an annual average increase of 19.3 per cent in the preceding five years (1998-2003). Food subsidies – the single largest component with a share of 56.0 per cent in total subsidies – could be contained on account of a lower carrying cost of food stock during the year (Chart 10).

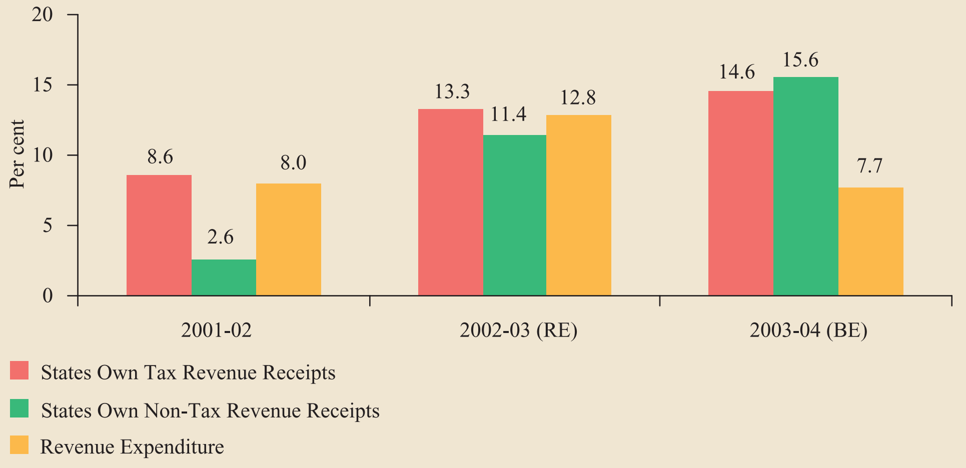
Chart 10 : Composition of Subsidies



State Finances

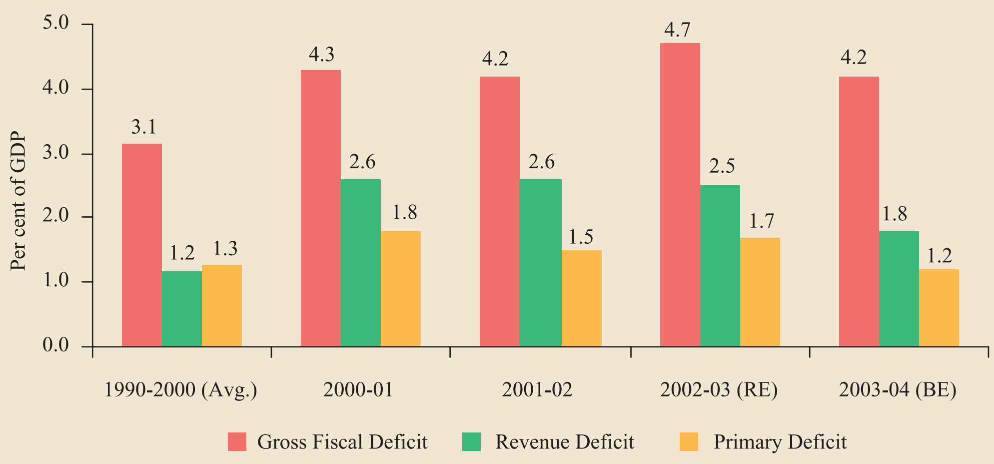
The finances of State Governments were budgeted to record an improvement during 2003-04, with all key deficit indicators placed lower than in the previous year. A reduction of 0.7 percentage points in the revenue deficit/GDP ratio was envisaged through growth in revenue receipts (13.7 per cent) outpacing revenue expenditure (7.7 per cent) (Chart 11).

Chart 11 : Growth in States' Own Revenue Receipts and Expenditure



With the compression in the revenue deficit, the gross fiscal deficit (GFD) and the primary deficit were also budgeted to narrow by a similar magnitude as proportions to GDP (Chart 12).

Chart 12 : Deficit Indicators of State Governments



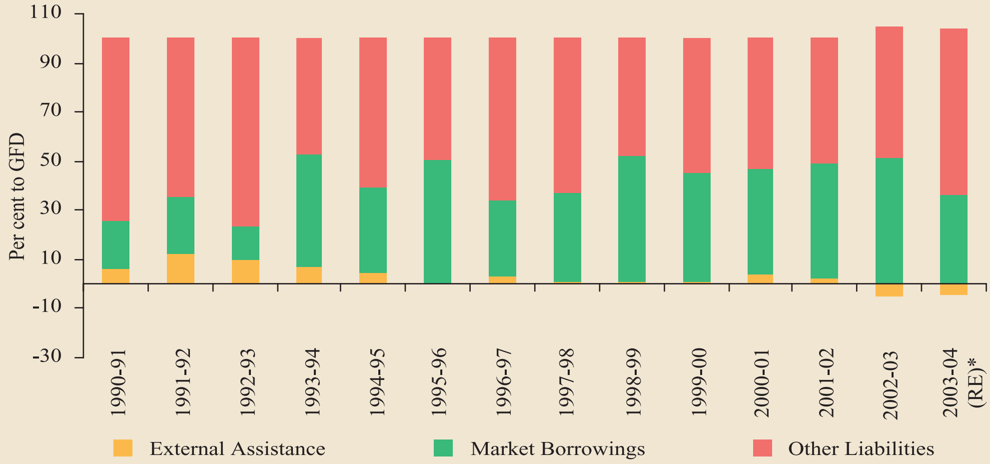
The State budgets for 2003-04 emphasised fiscal rectitude through measures for revenue augmentation, expenditure containment and institutional reforms to strengthen the process of fiscal consolidation. On the revenue front, strengthening of tax efforts and rationalisation of user charges mainly relating to power, water and transport are under way. Some States have proposed introduction of a contributory pension scheme for their newly recruited staff. Twenty one States have constituted State Electricity Regulatory Commissions (SERCs) for determining the power tariff structure. Of these, SERCs of 17 States have become operational and 16 have issued tariff orders.

Some States have initiated measures to provide statutory backing to fiscal reforms through enabling legislation. The objective is to eliminate the revenue deficit and contain the fiscal deficit in the medium term. The States of Karnataka, Kerala, Punjab, Tamil Nadu and Uttar Pradesh have already enacted Fiscal Responsibility legislation. A bill has also been introduced in the legislature of Maharashtra. The Central Government supports States' Medium-Term Fiscal Reforms Programmes (MTFRP) covering targets for broad fiscal indicators, restructuring of public sector enterprises, power sector reforms and fiscal transparency. It has set up an Incentive Fund to encourage States to implement monitorable fiscal reforms.

Financing Patterns

The combined fiscal deficit was entirely financed from domestic sources. The share of 'other liabilities' - small savings, provident funds and deposits – in financing increased from 53.7 per cent in 2002-03 to 68.2 per cent in 2003-04. The proportion of the combined deficit financed through market borrowings fell from 51.0 per cent to 36.0 per cent over the same period, reflecting the effect of debt swap transactions. Actual net market borrowings (including on account of debt swap transactions) amounted to Rs.1,35,475 crore *vis-a-vis* Rs.99,160 crore in the revised estimates. External financing continued to record net outflows for the second consecutive year, reflecting prepayments of external debt (Chart 13).

Chart 13 : Financing Pattern of the Combined GFD



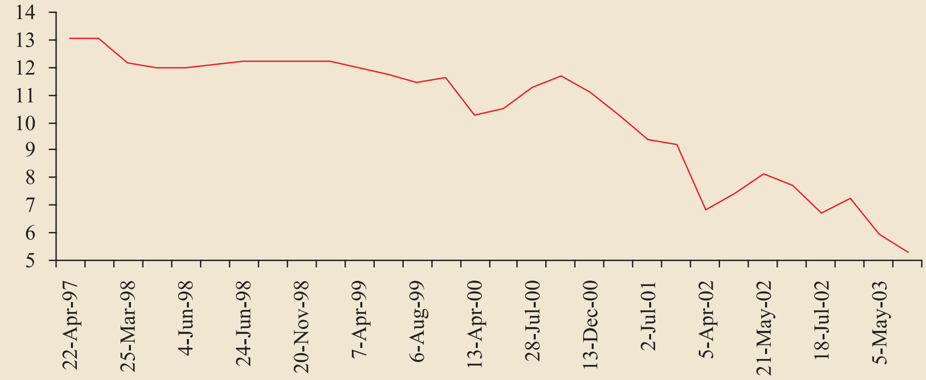
*: For States, data pertain to budget estimates.

Financing of the Union Budget

Gross market borrowings of the Centre for 2003-04 were budgeted at Rs.1,65,887 crore and the net market borrowings at Rs.1,07,194 crore. The revised estimates for 2003-04 placed the net borrowings at Rs.85,671 crore, 20.1 per cent lower than the budget estimates. Actual net market borrowings amounted to Rs. 88,816 crore during 2003-04. Although there is no impact of the DSS on the fiscal deficit of the Central Government, these transactions did result in a compositional change in the financing pattern of the GFD. Market borrowings (dated securities and 364-day Treasury Bills) financed 64.9 per cent of the GFD and the securities issued against small savings financed around 45.7 per cent. The latter represent the reinvestment by the NSSF out of the proceeds received on redemption of Special Central Government securities. The surplus cash balances amounted to Rs.13,697 crore and accounted for 10.4 per cent of the GFD.

Interest rates on market borrowings continued to decline with liquidity conditions remaining comfortable. The yield on the 10-year benchmark security declined to 5.32 per cent in the primary market by February 16, 2004 (Chart 14).

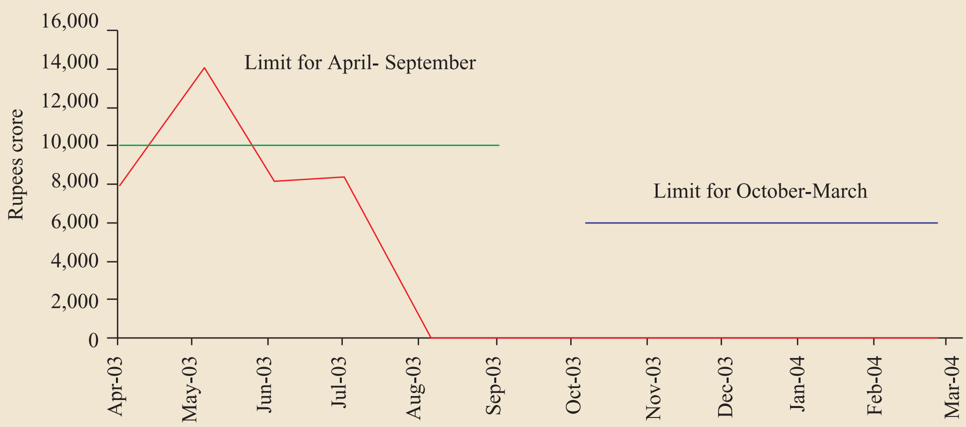
Chart 14 : Primary Benchmark Yields – Centre



Note: Last Primary Issue of 10-Year Security of the Central Government during 2003-04 was on February 16, 2004

The agreed limits on the Centre's Ways and Means Advances (WMA) from the Reserve Bank for the first and second halves of 2003-04 were set at Rs.10,000 crore (April-September) and Rs.6,000 crore (October-March), respectively. The average utilisation of WMA, at Rs.3,947 crore, was lower than in the preceding year (Chart 15). The Centre resorted to ways and means advances (Rs.245 crore) on April 30, 2004 for the first time since August 8, 2003.

Chart 15 : Month-end WMA Position of the Centre



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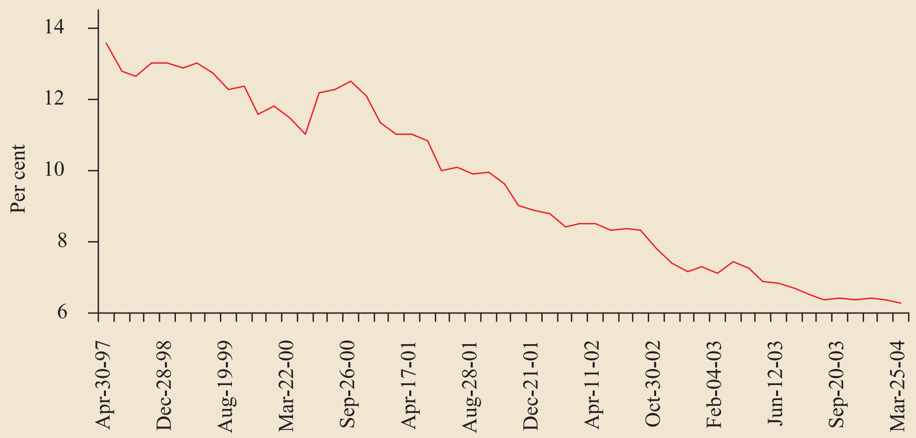
Financing of State Budgets

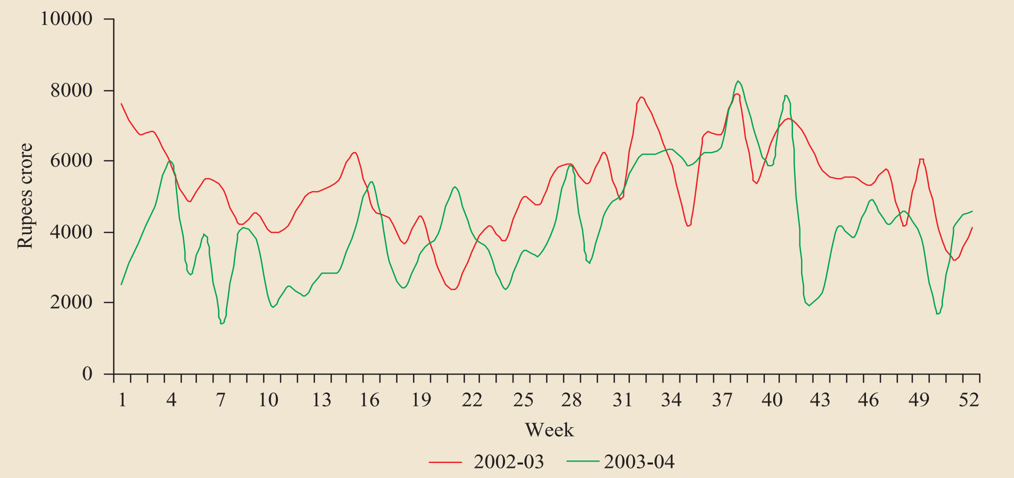
The net market borrowings allocated to States for 2003-04 amounted to Rs. 46,659 crore including additional allocation of Rs. 29,000 crore under the DSS. Taking into account the repayment of Rs. 4,145 crore, the gross allocation amounted to Rs. 50,805 crore. Of Rs.29,000 crore allocated under the DSS, Rs.26,623 crore went towards repayment of debt under the DSS while a few States were allowed to retain a part of the DSS amount for other purposes and a small portion of the DSS amount remained unsubscribed. The gross market borrowings raised by State Governments during 2003-04 amounted to Rs.50,521 crore (Rs.47,626 crore through tap sale and Rs.2,895 crore through auction). In consonance with the declining trend in interest rates, the interest rates on States' market borrowings fell to a range of 5.78-6.40 per cent during 2003-04 from a range of 6.6-8.0 per cent in 2002-03 (Chart 16).

Chart 16 : Primary Benchmark Yields – States



Although data on the actual fiscal outturn of the State Governments during 2003-04 are not yet available, recourse to WMA and overdrafts (ODs) by States during 2003-04 was generally lower than in the previous year suggesting improved management of cash flows (Chart 17).

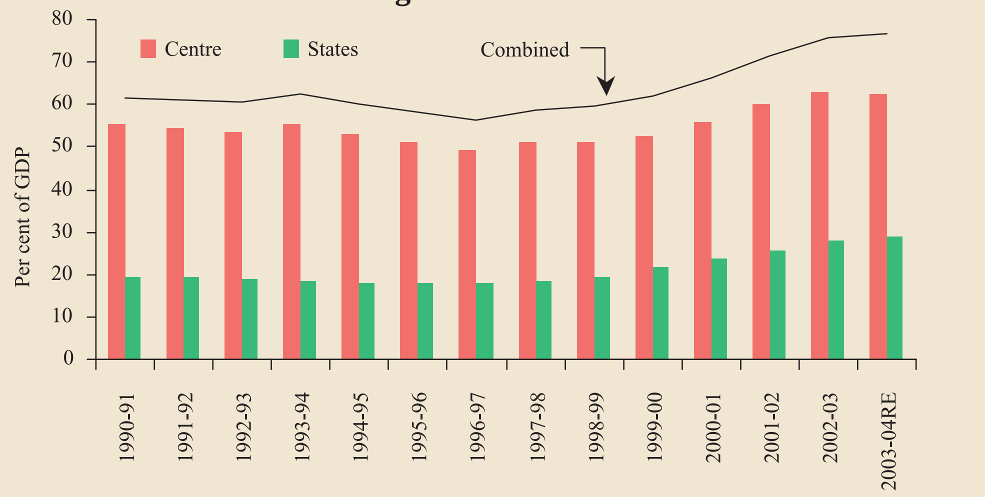
Chart 17 : Outstanding WMA and Overdrafts to States



Public Debt

The combined debt-GDP ratio of the Centre and the States is estimated to have increased to 76.6 per cent in 2003-04 from 75.8 per cent in 2002-03 (Chart 18). The weighted average maturity of Central Government dated securities issued during 2003-04 was higher at 14.94 years as against 13.83 years in the previous year. The weighted average yield also fell to 5.74 per cent from 7.34 per cent in the preceding year. There were three issues of floating rate bonds on May 20, 2003, August 8, 2003 and November 10, 2003 with the rate linked to the 364-day Treasury Bill rate and mark-ups ranging between 9-14 basis points.

Chart 18 : Outstanding Liabilities of Centre and States



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The Fiscal Outlook

The Interim Budget for 2004-05 has reiterated a commitment to the process of fiscal consolidation. Revenue receipts are budgeted to grow by 10.6 per cent and aggregate expenditure would decline by 3.5 per cent. Accordingly, all major deficit indicators are expected to be lower in 2004-05 as proportions to GDP than the revised estimates for 2003-04 (Table 9).

Table 9 : Interim Union Budget 2004-05 at a Glance

(Rupees crore)

Item	2003-04 (RE)	2004-05 (BE)	Variation (3 over 2) Amount	Per cent
1	2	3	4	5
1. Revenue Receipts (i+ii)	2,63,027 (9.5)	2,90,882 (9.4)	27,855	10.6
i. Tax Revenue	1,87,539 (6.8)	2,20,132 (7.1)	32,593	17.4
ii. Non-tax Revenue	75,488 (2.7)	70,750 (2.3)	-4,738	-6.3
2. Non-Plan Expenditure	3,52,748 (12.8)	3,22,363 (10.4)	-30,385	-8.6
of which:				
i. Interest Payments	1,24,555 (4.5)	1,29,500 (4.2)	4,945	4.0
ii. Defence	60,300 (2.2)	66,000 (2.1)	5,700	9.5
iii. Subsidies	44,707 (1.6)	45,175 (1.5)	468	1.0
3. Plan Expenditure	1,21,507 (4.4)	1,35,071 (4.4)	13,564	11.2
4. Revenue Expenditure	3,62,887 (13.2)	3,80,742 (12.3)	17,855	4.9
5. Capital Expenditure	1,11,368 (4.0)	76,692 (2.5)	-34,676	-31.1
6. Revenue Deficit	99,860 (3.6)	89,860 (2.9)	-10,000	-10.0
7. Gross Fiscal Deficit	1,32,103 (4.8)	1,36,452 (4.4)	4,349	3.3
8. Gross Primary Deficit	7,548 (0.3)	6,952 (0.2)	-596	-7.9

BE: Budget Estimates. RE: Revised Estimates.
Note: Figures in brackets are proportions to GDP in per cent.

Under revenue receipts, tax revenue is projected to increase by 17.4 per cent. A major portion of the increase in tax revenue is estimated to emanate from corporation tax and service tax. Consequently, the gross tax-GDP ratio of the Central Government is expected to rise to 9.7 per cent in 2004-05 from 9.3 per cent in the revised estimates for 2003-04. Non-tax revenue, on the other hand, is budgeted to decline by 6.3 per cent on account of a sharp fall in dividends and profits. As regards aggregate expenditure, revenue expenditure is budgeted to grow by 4.9 per cent while capital expenditure is expected to be lower by 31.1 per cent, mainly on account of reduction in non-plan capital expenditure. The sharp contraction in non-plan capital expenditure reflects the absence of any provision for public debt repayments as a capital expenditure item as was the case in the revised estimates for 2003-04. Among the major non-Plan revenue expenditure items, interest payments, defence expenditure and subsidies taken together would account for 73.9 per cent of the non-Plan revenue expenditure. Total Plan expenditure is budgeted to rise by 11.2 per cent during 2004-05. Capital outlay (both Plan and non-plan) is budgeted to rise by 31.1 per cent over the revised estimates, implying a better quality of fiscal adjustment.

During 2004-05, net market borrowings are budgeted higher at Rs.90,502 crore than Rs.85,671 crore in the revised estimates for 2003-04. Inclusive of repayments to the tune of Rs.60,356 crore, the gross market borrowings are placed at Rs.1,50,858 crore. Net market borrowings would finance 66.3 per cent of GFD in 2004-05 as compared with 64.9 per cent in the revised estimates for 2003-04. The fiscal correction envisaged in the Interim Budget provides a foundation for the implementation of the provisions in the Fiscal Responsibility and Budget Management Act, 2003 for fiscal consolidation.

III. Monetary and Liquidity Conditions

Monetary Trends

Monetary conditions continued to ease during 2003-04. Reserve money expansion was higher than in 2002-03 even though large and persistent capital inflows were substantially sterilised by outright open market operations (OMOs) and repos under the Liquidity Adjustment Facility (LAF). Overall monetary expansion was also higher than in the preceding year, *albeit* in consonance with higher output growth. Money supply accelerated to 15.3 per cent as on April 16, 2004 from 13.3 per cent as on April 18, 2003. In terms of the residency-based broad money (NM_3), which, *inter alia*, excludes the impact of the redemption of Resurgent India Bonds (RIBs) during the year, monetary expansion was even higher. Non-food credit started picking up from August 2003 onwards with the firming up of industrial activity and consumer demand. Liquidity in the financial system continued to be ample, even as substitution occurred between time deposits in the banking system and small savings. As a consequence, the liquidity aggregates (L_1, L_2, L_3) recorded a higher order of expansion in 2003-04 (Table 10).

Table 10 : Monetary Indicators

(Amount in Rupees crore)

Item	Outstanding as on March 31, 2004	Variation 2002-03 Absolute	Variation 2002-03 Per cent	Variation 2003-04 Absolute	Variation 2003-04 Per cent
1	2	3	4	5	6
I. Reserve Money	4,36,429	31,091	9.2	67,368	18.3
II. Broad Money (M_3)	20,00,349	1,91,177	12.8	2,81,147	16.4
a. Currency with the Public	3,16,758	30,587	12.7	45,376	16.7
b. Aggregate Deposits	16,78,550	1,60,197	12.8	2,33,972	16.2
i. Demand Deposits	2,51,371	18,591	10.4	53,581	27.1
ii. Time Deposits	14,27,179	1,41,606	13.2	1,80,391	14.5
Of which: Non-Resident Foreign Currency Deposits	75,419	1,421	1.6	-16,852 @	-18.3 @
III. NM_3	19,53,960	1,95,951	13.8	3,08,498	18.7
IV. a. L_1	20,23,153	2,07,300	14.2	3,22,416	19.0
Of which : Postal Deposits	69,193	11,349	25.8	13,918	25.2
b. L_2	20,29,665	2,08,455	14.2	3,22,632	18.9
Of which : FI Deposits	6,512	1,155	22.5	216	3.4
c. L_3	20,49,966	2,08,604	14.0	3,23,359	18.7
Of which : NBFC Deposits	20,301	148	0.8	727	3.7
V. Major Sources of Broad Money					
a. Net Bank Credit to the Government (i+ii)	7,44,616	84,865	14.4	70,186	10.4
i. Net Reserve Bank Credit to Government	47,555	-31,499	-20.7	-73,125	-60.6
Of which : Centre	43,806	-28,399	-20.1	-69,179	-61.2
ii. Other Banks' Credit to Government	6,97,061	1,16,364	26.6	1,43,310	25.9
b. Bank Credit to Commercial Sector	10,11,074	87,897	11.6	1,18,986	13.3
Of which : Scheduled Commercial Banks' Non-food Credit	7,99,420	99,448	18.6	1,19,684	17.6
c. Net Foreign Exchange Assets of the Banking Sector	5,15,304	82,680	26.6	1,21,589	30.9

Data are provisional. @ Reflects RIB redemption effect. FI : Financial Institution

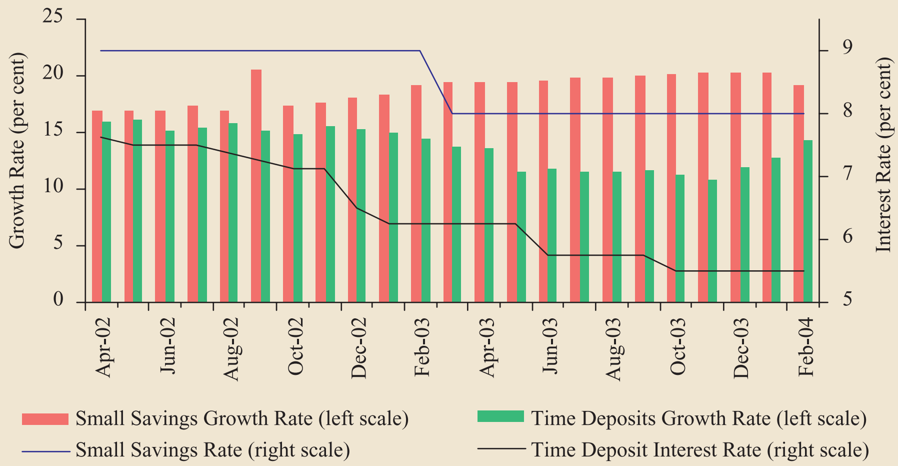
NBFC : Non-banking Financial Company

Notes: 1. Variations in M_3, NM_3, L_1, L_2, L_3 and deposits during 2002-03 are adjusted for the full impact of mergers and for the initial impact of mergers under bank credit.

2. Government balances as on March 31, 2004 are before closure of accounts.

Currency demand accelerated in 2003-04 reflecting the strong recovery in agricultural performance. The growth of banks' time deposits, though higher than in 2002-03, was compressed by the bullet redemption of RIBs in October 2003. Postal deposits recorded substantially higher expansion than time deposits as bank deposit rates were moderated during the year while interest rates and fiscal concessions on small savings remained unchanged (Chart 19).

Chart 19 : Time Deposits and Small Savings



Credit Behaviour

Non-food credit demand shrugged off an initial sluggishness and recorded an upsurge from mid-August 2003. Housing credit continued to be an important driver of credit growth, benefiting from tax incentives and lower interest rates. Retail credit was also strong, buoyed by reviving consumer demand. Credit to industry also picked up in the latter half of the year. During the year, there was increased recourse by corporates to internal sources of financing as well as to external commercial borrowings (ECBs) (Table 11). Food credit experienced a contraction on account of a steady decline in food stocks.

Table 11 : Key Sources of Funds to Industry

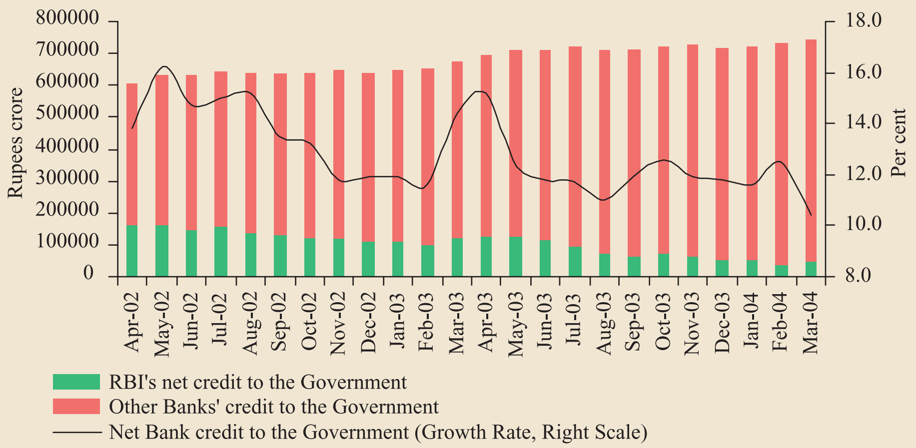
(Rupees crore)

	Component	2002-03	2003-04
	1	2	3
1.	Bank Credit to Industry #	24,189	10,307
2.	External Commercial Borrowings (including short-term trade credits) # #	-8,007	16,646
3.	Net Profits @	9,445	14,086
4.	Depreciation Provision @	8,860	9,525

\# Data relate to April-February and are inclusive of small-scale industries.
\## Data pertain to April-December and exclude RIB redemption effect.
@ Data relate to April-September period of each year and are based on the performance of 1,150 non-financial non-government companies.

The growth of net bank credit to the Government, at 10.4 per cent during 2003-04, was the lowest since 1994-95. A number of factors such as disinvestment proceeds, receipts under the Debt Swap Scheme, higher revenue buoyancy and higher mobilisation on account of Savings Bonds enabled a build-up of cash balances of the Central Government, which contributed to neutralising liquidity. Commercial banks' holdings of statutory liquidity ratio (SLR) securities, at 41.5 per cent of their net demand and time liabilities (NDTL) as at end-March 2004, remained far in excess of the statutory requirement (Chart 20).

Chart 20 : Net Bank Credit to the Government



Reserve Money

Reserve money was driven up by a record accretion to the net foreign exchange assets (NFEA) of the Reserve Bank during 2003-04 (Table 12). The expansion in the RBI's NFEA in the first quarter (ending June 2003) was largely unsterilised although the Centre's market borrowing programme was the heaviest in the quarter. Reserve money declined in the second quarter with the demand for currency exhibiting the usual seasonal contraction. A reduction in bankers' deposits with the Reserve Bank also occurred on account of a 25 basis point cut in the cash reserve ratio (CRR), effective June 14, 2003. With the relentless expansion in NFEA in the second quarter, sterilisation operations were undertaken in the form of open markets sales (Rs.16,671 crore) and primary auctions of the Centre's dated securities which pushed up the Centre's cash balances by Rs.24,395 crore. The Reserve Bank's NFEA accretion continued in the third quarter notwithstanding sales on account of the RIB redemptions and pre-payments of external debt. Sterilisation operations were stepped up (net OMO sales of Rs.14,225 crore and LAF repos of Rs.3,580 crore) but were lower than the expansionary effect of the massive NFEA accretion on reserve money.

This was also coincident with a pick-up in currency demand. Reserve money expansion continued in the fourth quarter with NFEA accretion unabated and accompanied by a further pick-up in currency demand. Sterilisation operations in the fourth quarter were through LAF repos (Rs.5,155 crore) and OMO sales (Rs. 5,332 crore). Reserve money expansion during the year was amplified also by a build up of bank reserves of Rs.19,662 crore during March 26-31, 2004, reflecting year-end considerations. The increase in reserve money has continued to remain higher at 12.7 per cent, on a year-on-year basis on April 30, 2004, than 11.6 per cent a year ago.

Table 12 : Reserve Money

(Rupees crore)

Item	2002-03	2003-04	2002-03				2003-04			
			Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
1	2	3	4	5	6	7	8	9	10	11
Reserve Money	**31,091 (9.2)**	**67,368 (18.3)**	**-8,850**	**6,791**	**7,917**	**25,233**	**16,342**	**-18,239**	**23,983**	**45,282**
Components										
1. Currency in circulation	31,499 (12.6)	44,550 (15.8)	14,633	-5,901	11,205	11,561	17,882	-5,955	17,986	14,636
2. Bankers' Deposits with the RBI	-801	21,019	-23,873	12,451	-2,427	13,048	-1,606	-12,633	5,961	29,297
3. 'Other' Deposits with the RBI	393	1,799	389	241	-861	625	65	349	36	1,349
Sources										
1. RBI's net credit to Government	-31,499	-73,125	-4,212	-19,779	-17,427	9,919	-4,451	-53,146	-12,506	-3,021
Of which : to Centre	-28,399 (-20.1)	-69,179 (-61.2)	1,455	-19,555	-17,882	7,583	434	-53,744	-15,844	-25
2. RBI's credit to Banks and Commercial Sector	-6,468	-2,728	-6,537	-784	8	844	-1,564	-2,525	-796	2,156
3. NFEA of the RBI	94,275 (35.7)	1,26,169 (35.2)	19,279	19,619	34,766	20,611	22,710	25,720	51,931	25,808
4. Government's Currency Liabilities to the Public	705	220	168	256	157	124	84	74	43	19
5. Net Non-Monetary Liabilities of RBI	25,922	-16,831	17,548	-7,479	9,587	6,265	437	-11,639	14,689	-20,319
Memo:										
1. Net Domestic Assets	-63,184	-58,801	-28,130	-12,829	-26,849	4,622	-6,368	-43,959	-27,948	19,473
2. FCA, adjusted for revaluation	82,090	1,41,428	8,145	22,881	31,060	20,004	23,943	31,832	37,560	48,093
3. Net Purchases from Authorised Dealers	75,661	1,40,650	3,929	18,958	25,165	27,608	22,237	29,899	40,669	47,845
4. NFEA/ Reserve Money (per cent) (end-period)	97.1	111.0	86.1	90.2	98.2	97.1	98.8	110.8	117.2	111.0
5. NFEA/Currency (per cent) (end-period)	126.8	148.1	106.6	116.6	124.6	126.8	126.8	138.1	146.8	148.1

NFEA : Net Foreign Exchange Assets; FCA : Foreign Currency Assets.

Notes: 1. Data based on March 31 for Q_4 and last reporting Friday for all other quarters.

2. Government balances as on March 31, 2004 are before closure of accounts.

3. Figures in brackets are percentage variations during the year.

The Reserve Bank's foreign currency assets increased by Rs.1,41,428 crore, net of revaluation, in 2003-04, with the NFEA/currency (150.8 per cent) and NFEA/ reserve money (120.7 per cent) ratios peaking in February 2004 (Chart 21).

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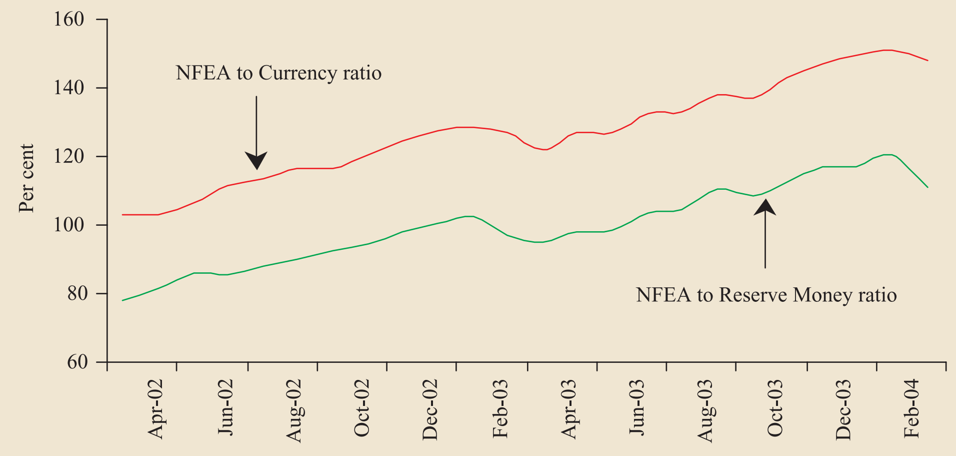
Chart 21 : Reserve Bank's Net Foreign Exchange Asset Ratios



The Reserve Bank's primary support by way of its own subscriptions to the Centre's fresh dated securities (including Rs.5,000 crore to fund the Centre's pre-payment of external debt) during 2003-04 was lower than in 2002-03 (Table 13).

Table 13 : Net Reserve Bank Credit to the Centre

(Rupees crore)

Item	2002-03	2003-04	2002-03				2003-04			
			Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
1	2	3	4	5	6	7	8	9	10	11
Net Reserve Bank Credit to the Centre (1+2+3+4-5)	**-28,399**	**-69,179**	**1,455**	**-19,555**	**-17,882**	**7,583**	**434**	**-53,744**	**-15,844**	**-25**
1. Loans and Advances	-5,176	0	2,472	-7,648	0	0	8,145	-8,145	0	0
2. Treasury Bills held by the Reserve Bank	-15	-3	-18	0	0	3	-3	0	0	0
3. Reserve Bank's Holdings of Dated Securities	-24,731	-72,227	-6,107	-11,761	-17,979	11,116	-11,300	-45,530	-15,795	398
4. Reserve Bank's Holdings of Rupee Coins	-92	20	64	-146	97	-106	163	-68	-51	-24
5. Central Government Deposits	-1,614	-3,030	-5,044	0	0	3,431	-3,430	0	-1	401
*Memo Items**										
1. Market Borrowings of Dated Securities by the Centre #	1,25,000	1,21,500	49,000	35,000	23,000	18,000	44,000	36,000	15,000	26,500
2. Reserve Bank's Primary Subscription to Dated Securities	36,175	21,500	22,018	1,157	0	13,000	5,000	0	0	16,500
3. Repos (-) / Reverse Repos (+) (LAF), net position £	1,940	-32,230	-20,355	8,845	10,371	3,079	-25,052	1,557	-3,580	-5,155
4. Centre's Surplus Investment	8,905	17,764	0	2,005	12,624	-5,724	-8,905	24,395	-2,355	4,629
5. Net Open Market Sales #	53,781	41,849	7,020	19,918	15,693	11,150	5,620	16,671	14,225	5,332
6. Primary Operations $	23,616	6,786	29,598	-8,642	-12,527	15,187	25,643	-32,608	2,304	11,446

* At face value. # Excludes Treasury Bills. £ Includes fortnightly repos. $ Adjusted for Centre's surplus investment.

Notes : 1. Quarterly variations are based on March 31 for Q4 and last reporting Fridays for other quarters.
2. Government balances as on March 31, 2004 are before closure of accounts.

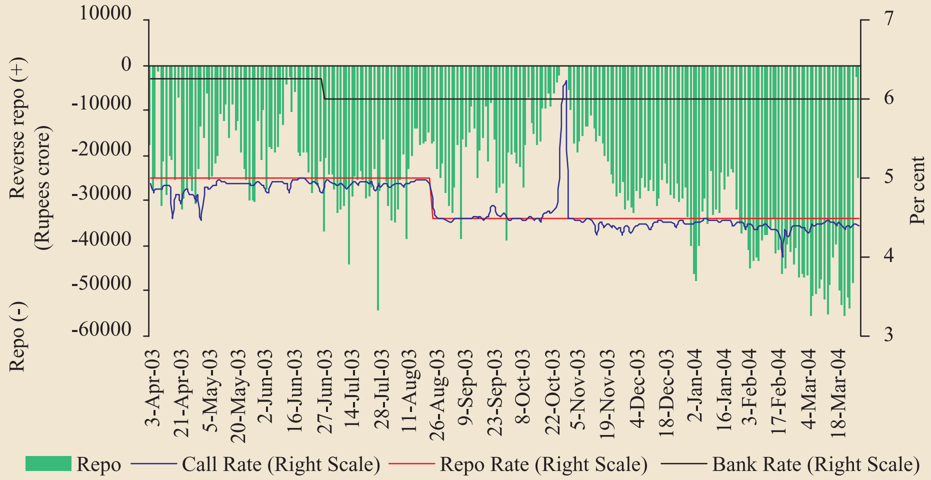
Consequent upon the building of cash balances by the Centre and sizable sterilisation operations, the Reserve Bank's net credit to the Centre declined sharply and net domestic assets of the Reserve Bank registered a corresponding decline. The net Reserve Bank credit to the Centre declined by Rs. 1,18,975 crore, on a year-on-year basis, on April 30, 2004, as a result of sterilisation operations to nuetralise the monetary impact of the accretion of Rs. 1,66,472 crore (adjusted for revaluation) to foreign currency assets.

Liquidity Adjustment Facility

The Liquidity Adjustment Facility (LAF) remained the most important instrument of liquidity management during 2003-04. In the face of a high order of capital inflows, the LAF operated predominantly in an absorption mode with the repo rate emerging as an anchor for the spectrum of interest rates. The average daily repos outstanding was consistently higher than in 2002-03. There were, however, a few reverse repo bids at the beginning of the financial year to smoothen liquidity during primary auctions.

Heavy repo bidding in April 2003 (average daily repo outstanding at Rs.27,372 crore) ebbed in the subsequent months as the Centre's market borrowing programme gathered momentum. On June 14, 2003, tightening of restrictions on non-bank call lending was synchronised with a cut in the CRR to ensure a smooth transition. With the easing of liquidity conditions in July on account of the return flow of advance tax payments, repo bids soared again with a sharp increase in both the number and average size of bids. On August 23, 2003, the repo rate was lowered by 50 basis points to 4.5 per cent causing a temporary lull in repo biddings. Uncertainty in October on account of parallel open market sales and a series of 28-day repos to mop up excess liquidity was reflected in some

Chart 22 : Liquidity Adjustment Facility



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volatility in the call money market. Activity in the LAF repos picked up again from November 2003. Limits on the lending of non-bank participants in the call money market were lowered in December. In March 2004, the average daily repo outstanding increased to a high of Rs.54,915 crore with progressive diminution of open market sales and sustained external inflows (Chart 22).

With the introduction of daily 7-day repo and daily overnight fixed rate reverse repo on March 29, 2004, the spread between the repo rate and reverse repo rate has been reduced from 200 basis points to 150 basis points, with the 7-day fixed rate repo rate at 4.5 per cent and overnight reverse repo rate at 6.0 per cent. Taking into account both the 7-day and 14-day repos, the average daily repo amount outstanding during April 2004 was Rs. 75,218 crore (as compared with Rs. 27,372 crore during April 2003), reflecting the strong capital flows.

In pursuance of the recommendations of the Reserve Bank's Working Group on Instruments of Sterilisation, the Market Stabilisation Scheme (MSS) was introduced in April 2004 to strengthen the monetary authority's ability to conduct exchange rate and monetary management operations. Under the Memorandum of Understanding signed between the Government of India and the Reserve Bank on March 25, 2004, securities under the MSS are being issued with an initial overall ceiling of Rs.60,000 crore for the year 2004-05. An indicative schedule for issuance of MSS securities with a total auction amount of Rs.35,500 crore covering the first quarter of 2004-05 was announced on March 25, 2004. Treasury Bills and/or dated securities issued under the MSS would be the same as those issued for normal market borrowings and as such they would fortify the conduct of sterilisation operations without segmenting the government securities market. Paper issued under the MSS Scheme amounted to Rs. 23,000 crore by April 30, 2004.

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IV. Price Situation

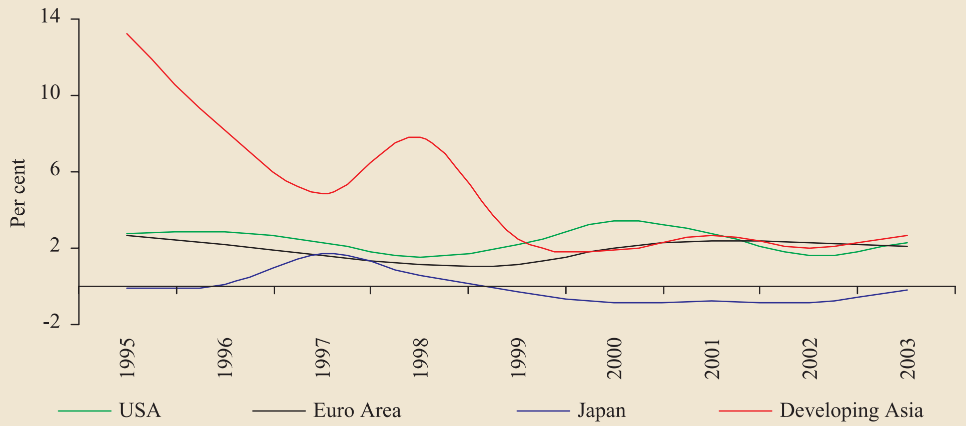
Inflation in India went through episodes of pressures before edging down in the last quarter of 2003-04. Globally, inflation remained subdued in several parts of the world. Downside risks of deflation receded during the year. Prices of basic and intermediate materials firmed up in association with signs of recovery in economic activity and the persistent hardening of international crude oil prices.

Global Inflation Environment

Inflation remained low in 2003, although inflationary expectations began to edge up in the second half of the year as signs of recovery became stronger and widespread. Monetary policy remained accommodative in various parts of the world in support of economic recovery, *albeit* with a growing recognition that some reversal could be necessary in the future. In the developed countries, inflation stayed below two per cent for the second year in succession while remaining close to six per cent in developing economies. In the US, headline consumer inflation fell to 1.7 per cent in March 2004 as the slack in resource utilisation remained substantial and productivity gains led to a decline in unit labour costs. In the United Kingdom, inflation remained well below the Bank of England's target of 2.0 per cent, although muted pressures from incipient demand growth led to a pre-emptive tightening of monetary policy. In the euro area, inflation stayed close to the European Central Bank's target of 2.0 per cent with pressures emanating from higher oil and food prices offset by the appreciation of the euro. Japan continued to experience deflation during 2003 although recovery in real GDP growth became stronger in the second half of the year.

In developing Asia, domestic demand picked up but did not translate into inflationary pressures (Chart 23). In China, consumer prices rose moderately on

Chart 23 : Consumer Price Inflation – Global Trends

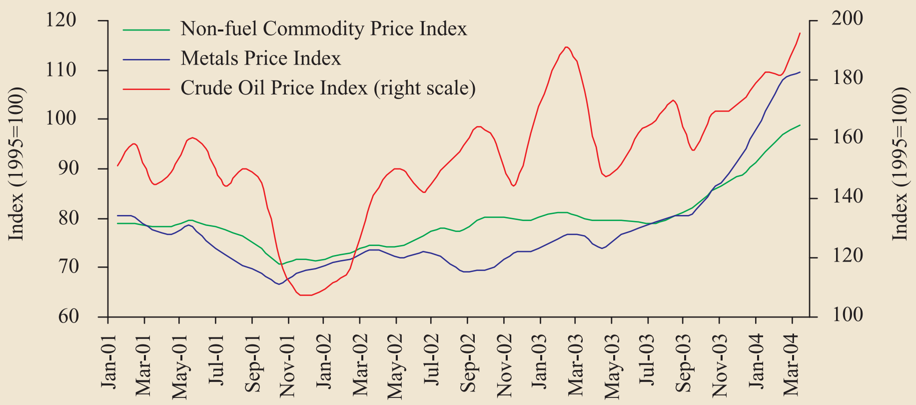


Source: International Monetary Fund

account of higher prices of food, farm products and metals. Countries in Africa and the Western Hemisphere, on the other hand, continued to face relatively high inflation risks.

International commodity prices surged in 2003 (Chart 24). Crude oil prices hardened from 2002 levels due to slower than expected resumption of oil production in Iraq, pick-up in economic activity, low levels of inventory in industrial countries and further cuts in production by the Organisation of Petroleum Exporting Countries (OPEC). Non-fuel commodity prices also rose sharply, mainly reflecting increased Chinese demand for metals and cotton, crop failures as well as the depreciation of the US dollar - the currency in which commodity prices are generally invoiced. The large increases in commodity prices were not transmitted into consumer prices in industrial countries but appear to have been absorbed in firms' profit margins, as commodity costs represent only a small share of overall costs in these economies.

Chart 24 : International Commodity Price Movements



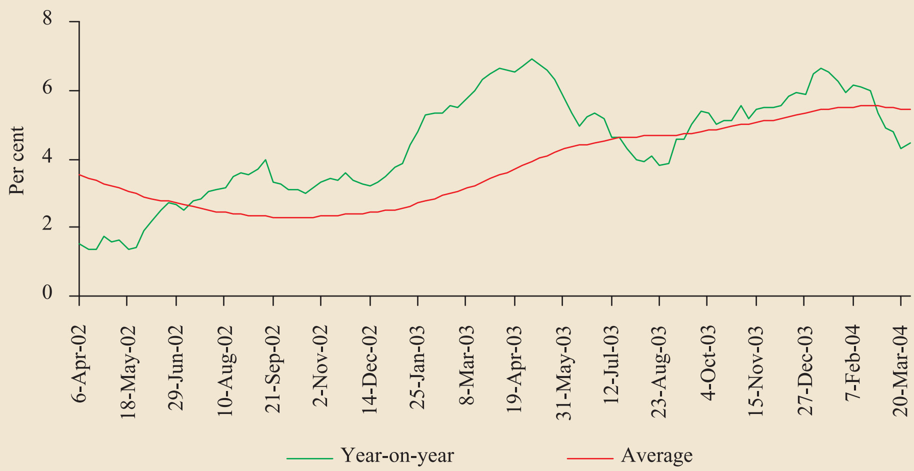
Source: International Monetary Fund.

Inflation Conditions in India

Headline inflation, measured by year-on-year (y-o-y) changes in the wholesale price index (WPI), peaked at 6.9 per cent in the first week of May 2003 as transport disruptions and an upward revision in electricity prices dispelled the effect of downward revisions in petroleum, oil and lubricants (POL) prices. Inflation receded thereafter to a trough of 3.8 per cent on August 23, 2003 driven down by declines in the prices of mineral oils, fruits, oil seeds, oil cakes and chemicals. Incipient inflationary pressures began to emerge from prices of iron and steel, vegetables, sugar and administered coal. Over the subsequent weeks, inflation rose to 6.6 per cent by January 10, 2004 due to hardening prices of mineral oils, cotton textiles, iron and steel and fruits. About a fifth of this rise in inflation was due to successive hikes in domestic petrol and diesel prices on December 16, 2003 and January 1, 2004. With the delayed seasonal fall in vegetable prices, a decline in prices of eggs and poultry chicken on fears of *avian influenza* and base effects of oil price hikes in February and March 2003, inflation decelerated to 4.5 per cent by end-March 2004. The year-on-year WPI inflation eased further to 4.3 per cent by April 24, 2004.

Rising prices of iron and steel, cotton textiles and international crude prices posed inflation concerns in the second half of the year. Sugar prices rose in the last quarter, reflecting lower domestic sugarcane production in the western belt due to persistent drought conditions as well as upward revisions in the statutory minimum prices for sugarcane. Annual WPI inflation, excluding the administered and partially decontrolled items (electricity, coal mining, mineral oils and urea-N-content), stood at 5.1 per cent in 2003-04, on a point-to-point basis, as compared with the headline rate of 4.5 per cent. On an annual average basis, WPI inflation was 5.4 per cent in 2003-04 as compared with 3.4 per cent a year ago (Chart 25).

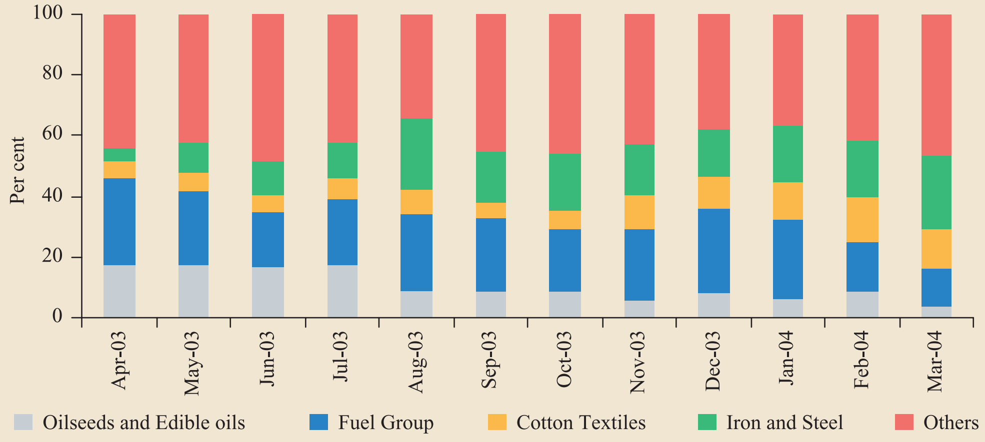
Chart 25 : Wholesale Price Inflation



Components of Inflation

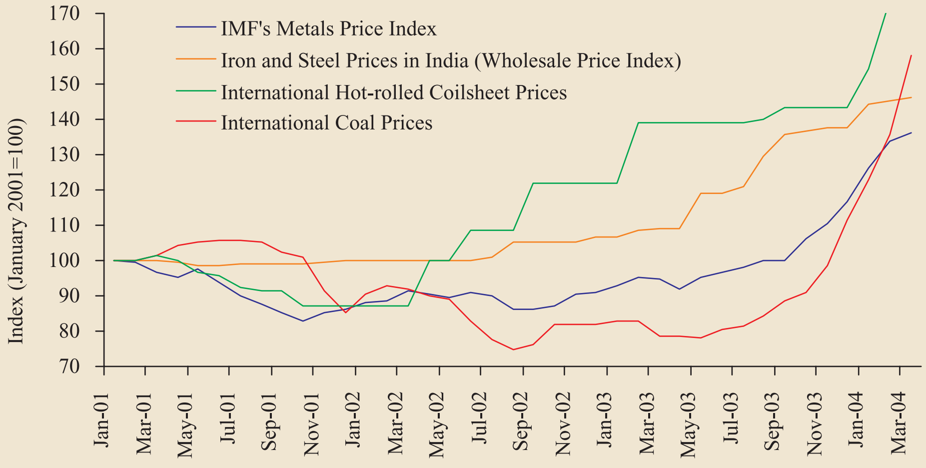
The key movers of headline inflation in 2003-04 were iron and steel, cotton textiles, fuel group, sugar and milk. These items, which have a weight of 30 per cent in the overall WPI index, accounted for 66 per cent of the headline inflation (Chart 26).

Chart 26 : Inflationary Pressure Points in 2003-04: Weighted Contribution



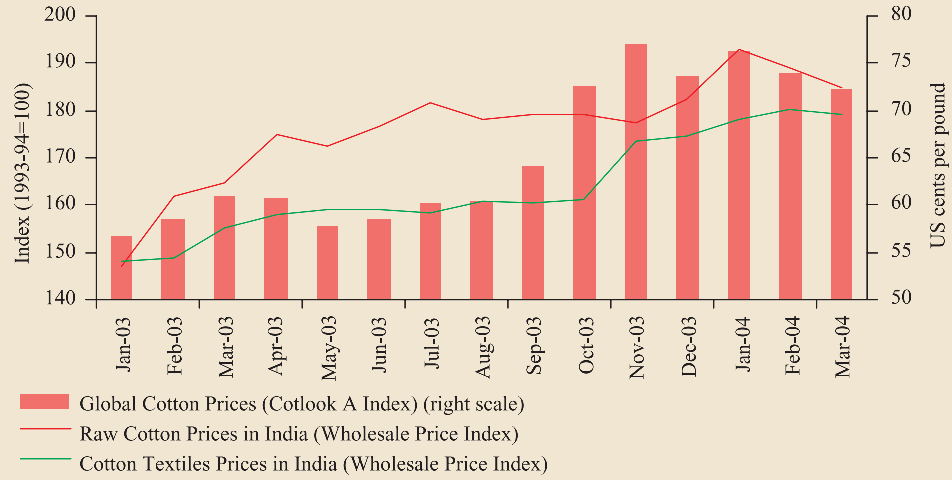
Domestic iron and steel prices increased by 34.2 per cent in 2003-04 and contributed almost a fourth of headline inflation. This was associated with the improvement in industrial activity and exports. It also reflected the movements in international prices which were driven up by increased Chinese demand for metals and rising input costs (Chart 27). During the last quarter of 2003-04, fiscal measures comprising cuts in customs and excise duties on inputs as well as finished products supported by freezing of benefits under the Duty Entitlement Pass Book and duty drawback schemes also helped in reining in inflationary pressures.

Chart 27 : Iron and Steel Prices



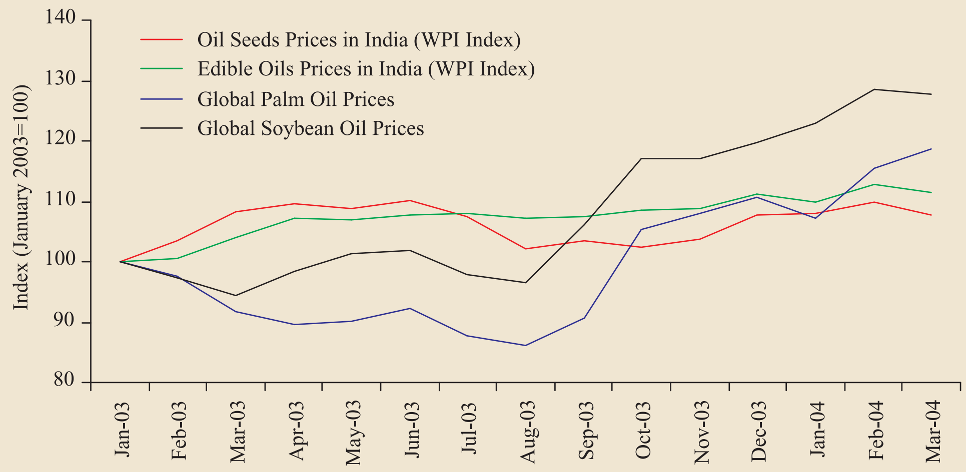
The increase in cotton textile prices was mainly on account of the rise in domestic raw cotton prices. Despite a satisfactory domestic cotton crop, raw cotton prices remained firm in consonance with international price movements. Global cotton prices increased during 2003, mainly reflecting higher Chinese demand and low stocks (Chart 28).

Chart 28 : Cotton Textile Prices



Domestic oilseeds prices were largely unchanged from their end-March 2003 level, reflecting a rebound in domestic oilseeds production. The prices of edible oils were, however, held up by import costs due to depleting Malaysian palm oil stocks and shortfalls in the production of soybean in the US (Chart 29).

Chart 29 : Edible Oil Prices



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The manufactured products group contributed 78.7 per cent to inflation in 2003-04 as compared with 44.3 per cent during 2002-03 (Table 14). This was primarily due to the spurt in global commodity prices, given the near exhaustion of excess capacities in major industries alongside the revival in economic activity.

Table 14 : WPI Inflation Rate (Year-on-year)

(Per cent)

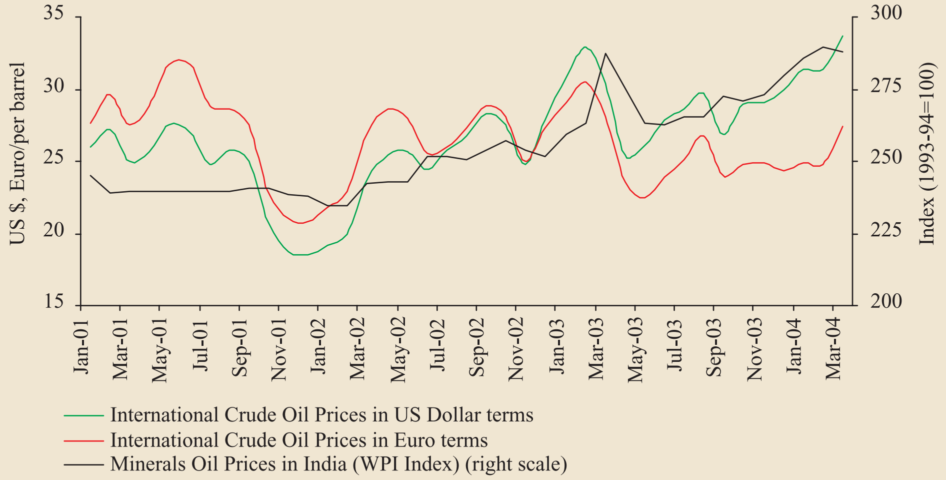
Commodity	Weight	Inflation Rate 2001-02	Inflation Rate 2002-03	Inflation Rate 2003-04P	Weighted Contribution 2001-02	Weighted Contribution 2002-03	Weighted Contribution 2003-04P
1	2	3	4	5	6	7	8
All Commodities	**100.0**	**1.6**	**6.5**	**4.5**	**100.0**	**100.0**	**100.0**
1. Primary Articles	**22.0**	**3.9**	**6.1**	**1.7**	**53.4**	**21.6**	**8.6**
Food Articles	15.4	5.2	0.8	0.7	51.5	2.2	2.4
i. Cereals	4.4	0.8	4.0	-0.2	2.4	2.9	-0.2
ii. Pulses	0.6	-3.3	0.3	-2.8	-1.4	0.0	-0.4
iii. Vegetables	1.5	23.4	-15.7	8.0	14.8	-3.0	1.8
iv. Fruits	1.5	9.5	7.6	-7.1	11.2	2.4	-3.3
v. Milk	4.4	4.7	0.6	7.5	12.9	0.5	7.3
vi. Eggs, Fish and Meat	2.2	9.3	-4.0	-6.3	14.3	-1.7	-3.4
Non-Food Articles	6.1	0.6	22.1	4.3	2.1	19.3	6.2
i. Raw Cotton	1.4	-21.3	34.3	12.3	-17.3	5.4	3.6
ii. Oilseeds	2.7	6.8	30.0	-0.5	9.0	10.6	-0.3
iii. Sugarcane	1.3	6.2	11.5	6.5	5.7	2.8	2.4
2. Fuel, Power, Light and Lubricants	**14.2**	**3.9**	**10.8**	**2.7**	**47.1**	**33.9**	**12.7**
i. Mineral Oils	7.0	1.2	18.4	0.2	7.8	29.7	0.5
ii. Electricity	5.5	9.2	3.4	4.9	41.3	4.2	8.4
iii. Coal Mining	1.8	-1.9	0.0	9.2	-2.4	0.0	3.8
3. Manufactured Products	**63.7**	**0.0**	**5.1**	**6.3**	**0.0**	**44.3**	**78.7**
i. Food Products	11.5	0.3	8.7	9.2	1.8	14.0	21.7
Sugar	3.6	-3.8	-15.0	16.8	-7.4	-7.0	9.0
Edible Oils	2.8	12.5	27.4	7.1	14.0	8.5	3.8
Oil Cakes	1.4	15.0	40.3	-1.0	11.5	8.8	-0.4
ii. Cotton Textiles	4.2	-6.7	8.3	15.3	-16.7	4.8	13.0
iii. Man-made Fibre	4.4	-5.0	17.4	-1.0	-7.1	5.8	-0.5
iv. Leather and Leather Products	1.0	-8.2	-1.1	15.1	-4.6	-0.1	2.6
v. Rubber and Plastic Products	2.4	0.8	6.0	1.5	0.9	1.7	0.6
vi. Chemicals and Chemical Products	11.9	2.5	4.2	0.1	19.3	8.2	0.3
Fertilisers	3.7	3.6	2.1	-0.1	8.1	1.2	-0.1
vii. Basic Metals, Alloys and Metal Products	8.3	-0.9	6.6	20.3	-4.2	7.3	32.8
Iron and Steel	3.6	0.0	9.2	34.2	0.0	4.4	24.3
viii. Non-Metallic Mineral Products	2.5	-2.8	3.3	3.0	-4.0	1.1	1.4
Cement	1.7	-4.7	1.1	1.3	-4.7	0.3	0.4
ix. Machinery and Machine Tools	8.4	2.0	0.5	3.0	8.0	0.5	4.2
Non-Electrical Machinery and Parts	3.4	5.4	2.5	3.4	10.4	1.2	2.4
Electrical Machinery	5.0	-1.1	-1.3	2.6	-2.5	-0.7	1.9
x. Transport Equipment and Parts	4.3	1.3	-0.9	1.2	3.1	-0.6	0.9

P Provisional.

Domestic mineral oil prices largely mirrored movements in international crude prices in 2003-04 with some cushion provided by the appreciation of the rupee against the US dollar. In the last quarter of 2003-04, however, domestic diesel and petrol prices remained largely unchanged even as international crude prices hardened due to depleting inventories in advanced economies, geopolitical uncertainties and concerns about production cut decisions by the OPEC.

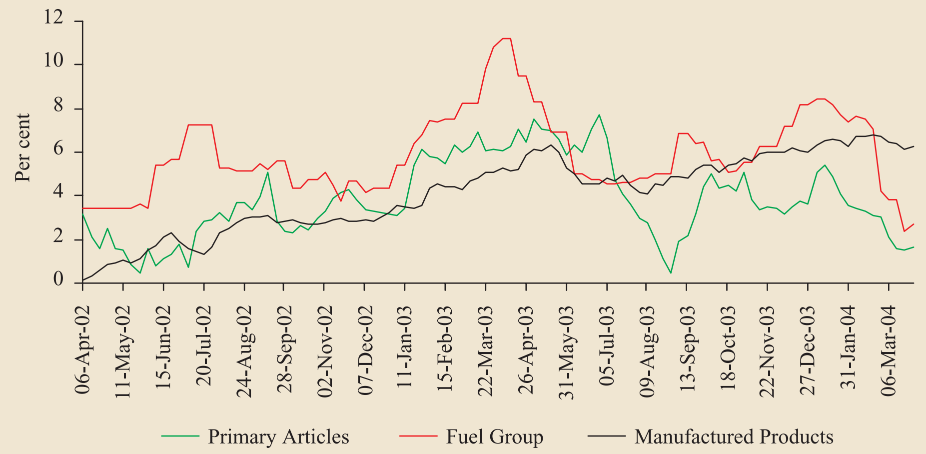
International average crude oil prices increased by 5.6 per cent to US $ 29.1 per barrel in 2003-04, ruling well above the upper ceiling of the OPEC band (Chart 30).

Chart 30 : Fuel Prices



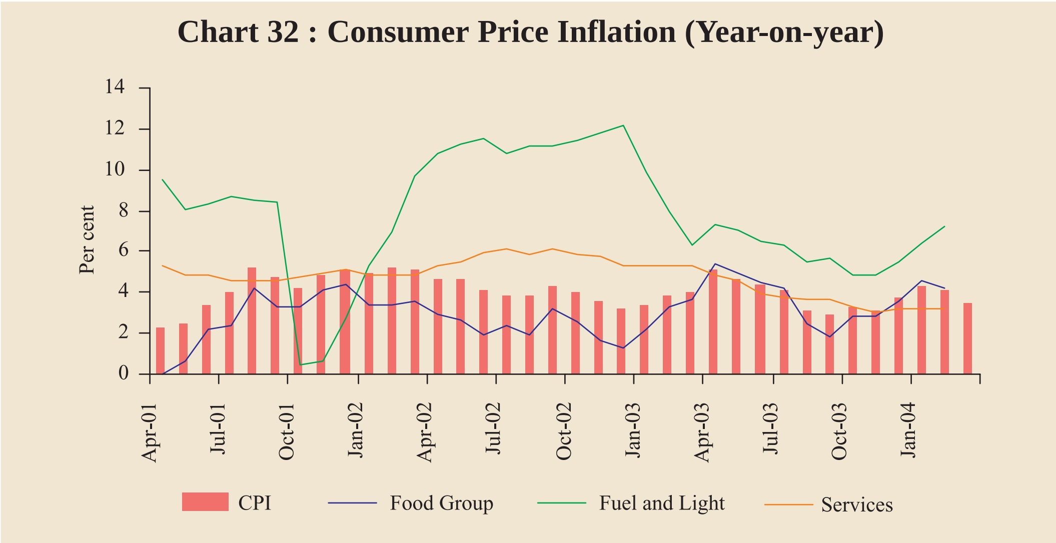
The strong rebound in agricultural production in 2003-04 generally dampened inflationary pressures in primary commodities (Chart 31). Vegetable prices, however, increased due to the impact of localised droughts in various parts of the country.

Chart 31 : WPI inflation of Major Groups (Year-on-year)

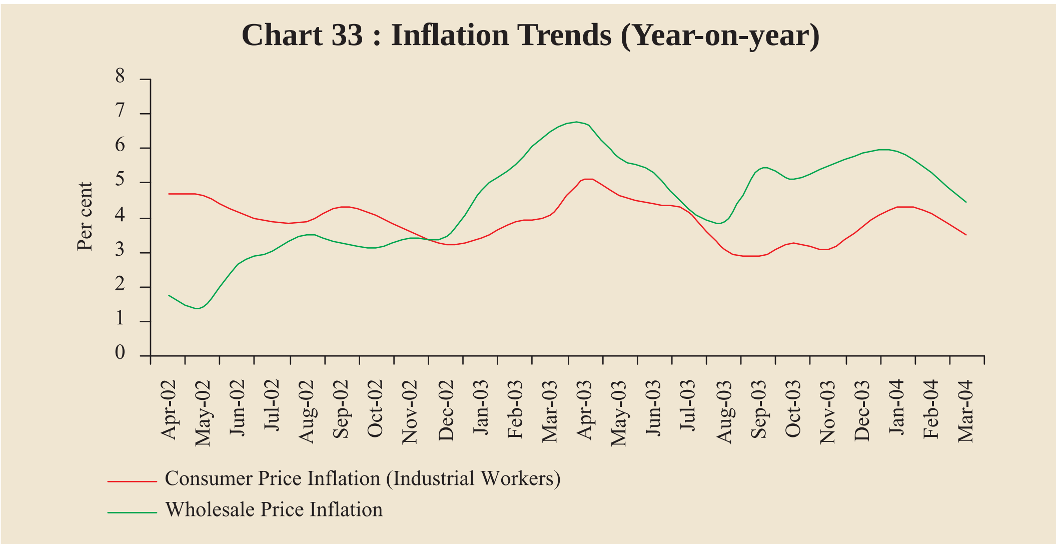


Consumer Price Inflation

Retail price inflation, measured by y-o-y variation in the consumer price index for industrial workers (CPI-IW), decelerated to 3.5 per cent in 2003-04 from 4.1 per cent a year ago. On an annual average basis also, CPI inflation at 3.9 per cent in 2003-04 was lower than 4.0 per cent in the previous year (Chart 32).



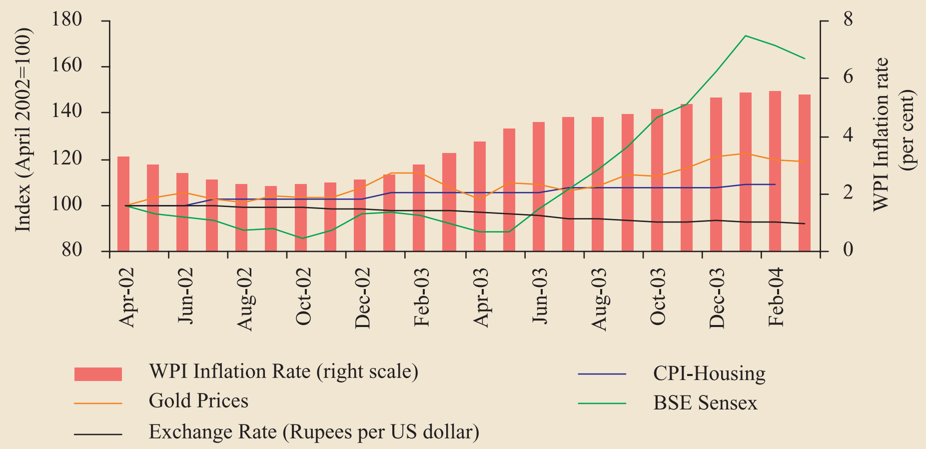
In contrast to WPI inflation, retail price inflation remained benign during 2003-04, reflecting the almost negligible weightage of iron and steel and lower weightage of fuel items - the two key movers of WPI inflation - in the CPI basket (Chart 33).



Asset Prices and Inflation

Asset prices contain information on how markets assess the benefits and risks of future macroeconomic developments. These expectations impact the current level of interest rates. Thus, asset prices provide a mechanism for a forward-looking monetary policy to be transmitted through financial markets to the real sector. Housing prices, exchange rates, stock prices and even prices of bullion have been identified as forming part of this transmission mechanism by generating wealth and competitiveness effects. Asset prices also affect balance sheets of banks as well as corporates and reinforce the credit channel of monetary policy transmission. During 2003-04, movements in equity and gold prices in India indicated a firming up of inflation expectations, partly offset by exchange rate appreciation and relatively stable housing prices (Chart 34).

Chart 34 : Asset Prices and Inflation



Outlook

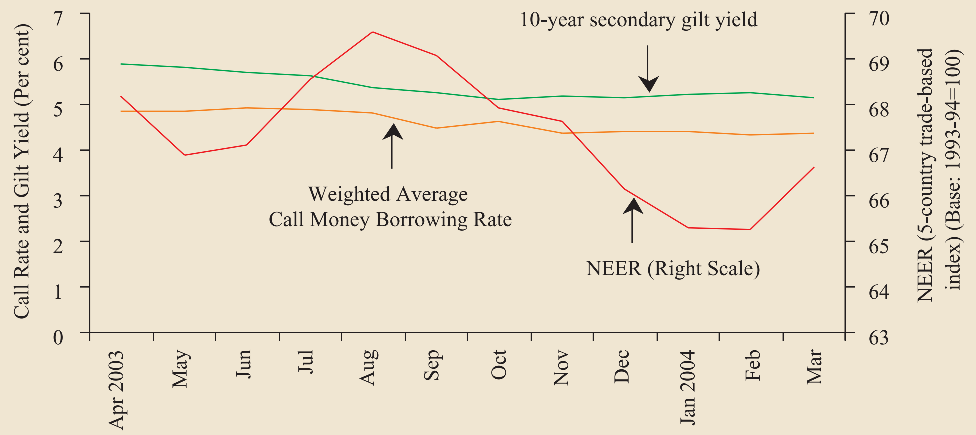
Inflation remains low and stable worldwide. Deflation risks have receded with the strengthening of global recovery and a number of commodity prices have risen in recent months. Indeed, the outlook is now fraught with the upward risk emanating from commodity markets, although there are also prospects of commodity prices levelling off in the medium term. Considerable uncertainty surrounds the prospects of international crude oil prices. The depreciation of the US dollar could be indicative of incipient inflation, however benign it may be in the current phase of the business cycle. Prices of key agricultural commodities will depend upon weather conditions.

In India, as domestic economic activity strengthens, inflation is likely to respond, with specific demand-supply conditions in key movers – iron and steel, cotton and fuel – dominating intra-year movements. A potential inflexion in inflation ahead would be triggered by the timing of adjustments in the prices of administered items, as also the possibility of a further spurt in global commodity prices.

V. Domestic Financial Markets

Financial markets were flush with liquidity generated by surges in external inflows during 2003-04. In the foreign exchange market, the rupee faced upward pressure *vis-a-vis* the US dollar throughout the year. Forward premia declined across the board in the second half of the year and even turned into discounts in the third quarter before firming up marginally towards the close of the year. Call rates remained stable, ruling persistently below the repo rate despite large sterilisation operations (Chart 35). Gilt yields softened during the first half of the year but remained generally range-bound in the second half as inflation edged up in January and February 2004. The yield curve flattened throughout the first half of the year, undergoing some correction from November with some firming of international interest rates and profit booking by investors.

Chart 35 : Call Rate, Gilt Yield and Nominal Effective Exchange Rate



In the credit market, ample liquidity conditions and the soft interest rate bias in monetary policy enabled banks to cut deposit rates. Lending rates also declined, though they remained relatively sticky. The introduction of the benchmark prime lending rate (PLR) system brought about some moderation from the level of tenor linked PLRs of the earlier regime. Non-food credit, which had been subdued in the first half of the year, started picking up after August 2003. Credit to medium and large industry decelerated while priority sector and retail lending recorded substantial increases. The equity market revived strongly from end-May 2003 in a broad-based rally (Table 15).

Table 15: Financial Markets at a Glance - 2003-04

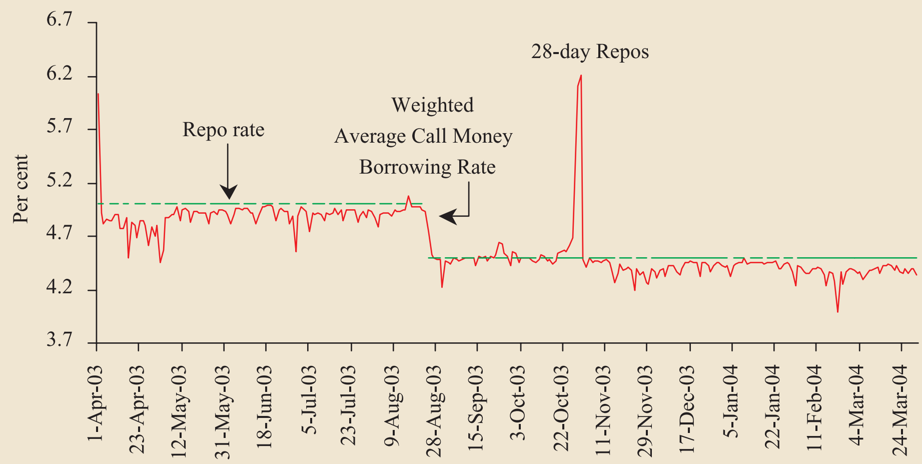
Month	Call Money		Gilt	Foreign Exchange				Liquidity Management			Equity			
	Average Daily Turnover (Rs. crore)	Average Call Rates (Per cent)	Turnover in Govt. Securities (Rs. crore)+	Average Daily Inter-bank Turnover (US $ million)	Average Excha-nge Rate (Rs. per US $)	RBI's net Foreign Currency Sales (-)/ Purch-ases(+) (US $ million)	Forward premia 3-month (Per cent)	Net OMO Sales(-) Purcha-ses (+) (Rs. crore]	Average Daily Repos (LAF) Outstan-ding (Rs. crore)	Average Daily Rev-erse-Repo (LAF) Outstan-ing (Rs. crore)	Average Daily BSE Turn-over (Rs. crore)	Average Daily NSE Turn-over (Rs. crore)	Average BSE Sensex	Average S & P CNX Nifty
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
April	17,338	4.87	2,26,803	5,585	47.38	1,432	2.08	-7	27,372	109	1,041	2,449	3037	965
May	18,725	4.87	2,99,933	5,960	47.08	2,342	1.1	-5,569	25,223	10	1,072	2,604	3033	963
June	20,544	4.91	3,00,504	5,837	46.71	896	2.76	-44	24,805	–	1,187	2,933	3387	1069
July	18,698	4.90	3,04,587	5,920	46.23	3,146	2.65	-57	42,690	39	1,434	3,429	3665	1150
August	19,556	4.83	4,09,539	5,983	45.93	2,352	2.25	-11,546	39,995	0	1,817	4,267	3978	1261
September	20,584	4.50	2,65,848	6,862	45.85	2,345	0.91	-5,107	31,373	0	2,032	4,698	4315	1369
October	23,998	4.64	3,89,968	7,672	45.39	1,593	0.02	-13,986	13,569	0	2,288	5,026	4742	1506
November	15,156	4.38	1,77,063	6,795	45.52	3,449	(-) 0.002	-69	21,182	0	2,251	4,644	4951	1580
December	15,276	4.40	1,81,991	6,207	45.59	2,888	(-) 0.30	-132	32,020	0	2,492	5,017	5425	1740
January	14,189	4.43	1,81,619	7,306	45.46	3,294	.0.50	-5,228	38,539	0	3,125	6,394	5954	1906
February	9,809	4.33	1,39,130	7,171	45.27	3,357	0.51	-35	46,244	0	2,709	5,722	5827	1849
March	12,422	4.37	2,22,685	8,018	45.02	3,382	0.62	-69	54,915	0	2,308	4,767	5613	1780

OMO: Open Market Operations. + Outright turnover in Central Government dated securities. LAF: Liquidity Adjustment Facility.
BSE: The Stock Exchange, Mumbai NSE: National Stock Exchange.

Money Market

The average daily call money borrowing rate remained below the repo rate over the greater part of the year, except in short-lived episodes in August and October 2003 (Chart 36). The sustained pace of capital flows left money markets with abundant liquidity in spite of continuous absorptions through repo and open market operations.

Chart 36 : Call Rate and the Repo Rate during 2003-04



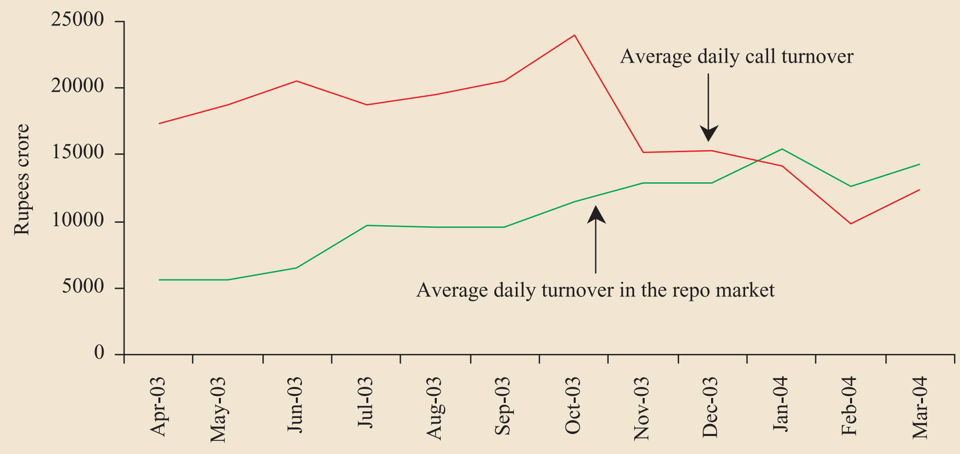
Unsterilised exchange market interventions, unwinding of the year-end tightness in liquidity and deferred government expenditure pushed the average call rate below the repo rate from April 2003. Fund outflows on account of State Government borrowings and open market sales resulted in isolated spikes in the call rate and some volatility in August related to the bomb blasts in Mumbai. The call rate adjusted smoothly to the 50 basis point repo rate cut, effective August 25, and hovered around the repo rate throughout September and early October, in spite of the redemption of the Resurgent India Bonds (Rs.22,693 crore). Measures by the Reserve Bank (28-day repos and open market operations) to absorb excess liquidity from the system in the second half of October resulted in temporary volatility in call rates. Stability returned quickly with the call rate remaining below the repo rate from November. The call rates dipped in February 2004 as large capital inflows continued and were largely unsterilised. They recovered in March to a little below the repo rate (Table 16). The call rates continued to be stable at about 4.3 per cent in a April 2004 with the average daily turnover working out to Rs. 12,916 crore.

Table 16 : Call/ Notice Money Market: 2003-04

Month	Average Call/Notice Money Borrowing Rate (Per cent)	Co-efficient of Variation of Call Rate	Average Daily Call/ Notice Money Turnover (Rs. crore)
1	2	3	4
April	4.87	0.07	17,338
May	4.87	0.02	18,725
June	4.91	0.02	20,544
July	4.90	0.01	18,698
August	4.83	0.04	19,556
September	4.50	0.01	20,584
October	4.64	0.09	23,998
November	4.38	0.02	15,156
December	4.40	0.01	15,276
January	4.43	0.01	14,489
February	4.33	0.02	9,809
March	4.37	0.01	12,422

The turnover in the call/notice money market declined during 2003-04 on account of a significant improvement in liquidity, reduction in CRR and higher placement of funds in LAF repos. There was also migration of a part of call borrowing to market repos and to the Collateralised Borrowing and Lending Operations (CLBO) segments on account of cheaper funding costs in these markets *vis-à-vis* the call/ notice market. With the tightening of prudential norms relating to the exposure of banks to the call market and the gradual phasing out of non-bank participants from the call market, activity in the repo market (outside the Reserve Bank) increased (Chart 37).

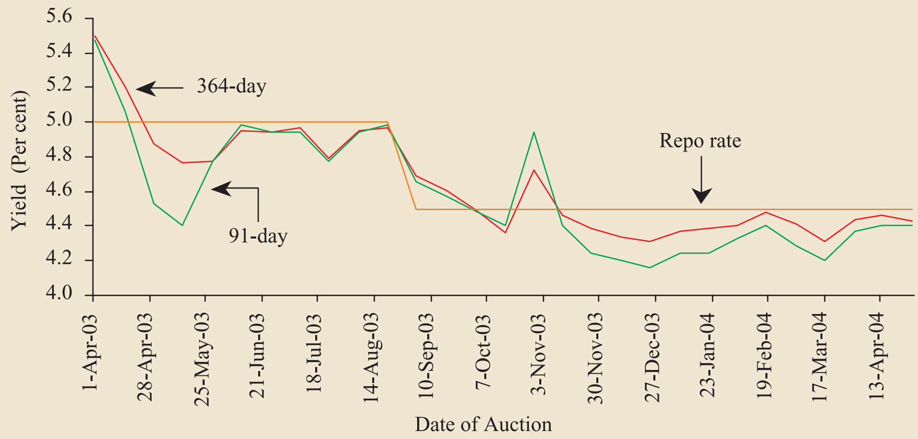
Chart 37 : Turnover in Call and Repo Markets



Treasury Bills

Primary yields of 91-day Treasury Bills and 364-day Treasury Bills moved synchronously with call rates, largely staying below the repo rate. Excess liquidity conditions in the beginning of the year evinced a vigorous market response to auctions with bid-cover ratios (ratio of competitive bid amount received to notified amount) crossing four for 91-day Treasury Bills and three for 364-day Treasury Bills around mid-April 2003. Yield spreads between the 91-day and 364-day instruments were virtually absent during end-May to August 2003. The notified amount of 91-day Treasury Bills was raised temporarily from Rs.500 crore to Rs.1,500 crore for eight auctions starting from August 6, 2003 to September 24, 2003, keeping in view the ample liquidity in the system. Temporary misalignment in the Treasury Bill yields was corrected when the notified amount of 91-day Treasury Bills was lowered to Rs.500 crore from October 1, 2003. Treasury Bill yields increased in January and February 2004 with edging up of inflation but softened by March as inflation fears subsided and conditions of surplus liquidity prevailed (Chart 38).

Chart 38 : Yields of Treasury Bills



Primary yields of Treasury Bills moved downward during 2003-04, but hardened marginally during February 2004, primarily on account of market uncertainty relating to the issue of securities under the market stabilisation scheme. Yields, however, fell back in March reflecting a large liquidity overhang in the system. Yields hardened again with the spread between 91-day and 364-day yields around three basis points on April 28, 2004 The bid-cover ratio indicated responsible participation in the auctions (Table 17).

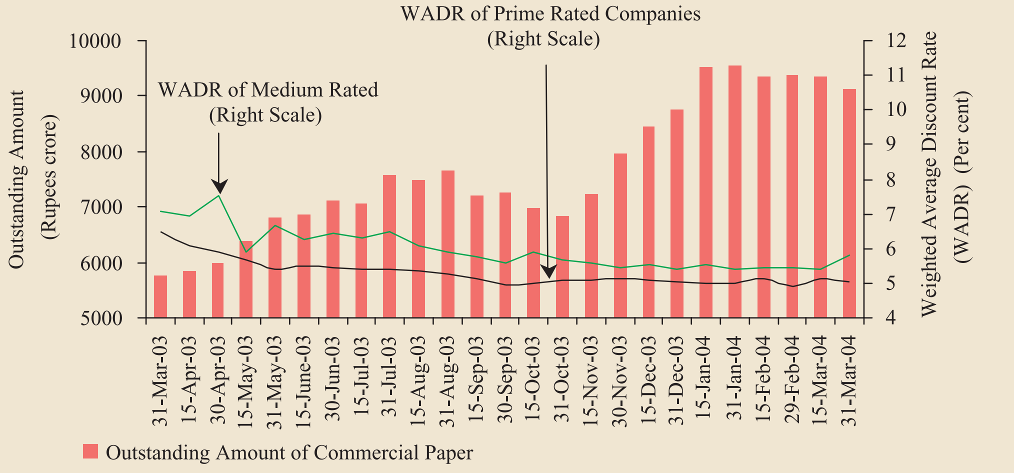
Table 17 : Treasury Bills in the Primary Market: 2003-04

	Average Implicit Yield at minimum cut-off Price (Per cent)		Bid-Cover Ratio	
	91-day	364-day	91-day	364-day
1	2	3	4	5
April	5.04	5.19	4.13	2.56
May	4.56	4.77	1.94	1.88
June	4.95	4.95	1.91	2.51
July	4.87	4.88	3.06	2.15
August	4.90	4.96	1.73	2.01
September	4.60	4.65	2.91	3.32
October	4.61	4.53	2.24	2.38
November	4.37	4.42	3.23	2.32
December	4.19	4.32	2.76	1.80
January	4.25	4.37	2.01	1.98
February	4.38	4.44	3.07	1.72
March	4.24	4.36	3.42	2.28

Other Money Market Instruments

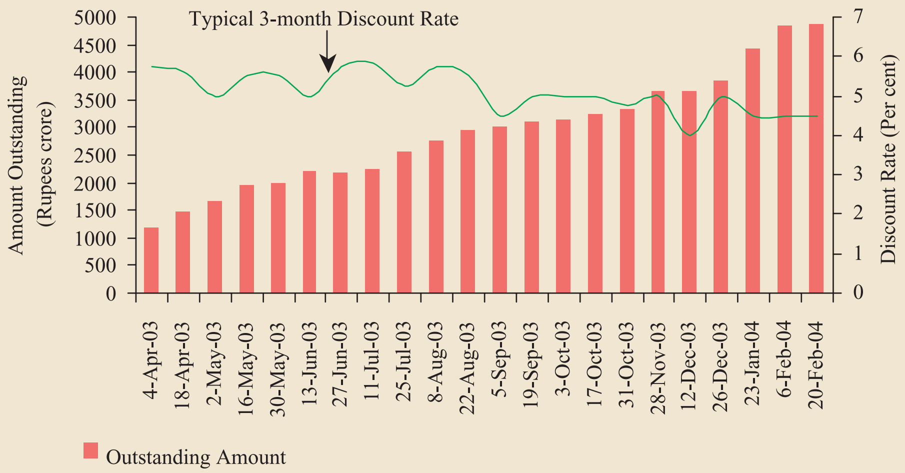
Comfortable liquidity conditions enabled companies to raise a higher volume of funds through the issue of commercial paper (CPs) during 2003-04. The outstanding amount of CPs increased from Rs.5,839 crore at the beginning of the year to Rs.7,646 crore by end-August 2003 before entering a period of slack through September 2003 and October 2003. Activity picked up in the CP market from December 2003 reflecting interest from mutual funds on account of the Securities and Exchange Board of India's (SEBI) guidelines on investments in non-SLR debt securities and market perception about cost effectiveness in issuances of CP *vis-à-vis* bonds and fixed deposits. Furthermore, reduction in stamp duty on CP issuances boosted this market. There was a decline in the amount of CPs outstanding during February and March 2004. As on April 15, 2004 the amount of outstanding CPs was Rs.9,590 crore. With the softening of interest rates across the money market, the weighted average discount rate (WADR) of prime rated companies declined by 112 basis points during 2003-04 while that of medium rated companies declined by 129 basis points (Chart 39).

Chart 39 : Commercial Paper Market - 2003-04



The outstanding amount of certificates of deposit (CDs) increased from Rs.1,188 crore in early April 2003 to Rs.4,831 crore by early-March 2004 mainly on account of issuances by some banks with low deposit bases (Chart 40).

Chart 40 : Certificates of Deposit - 2003-04

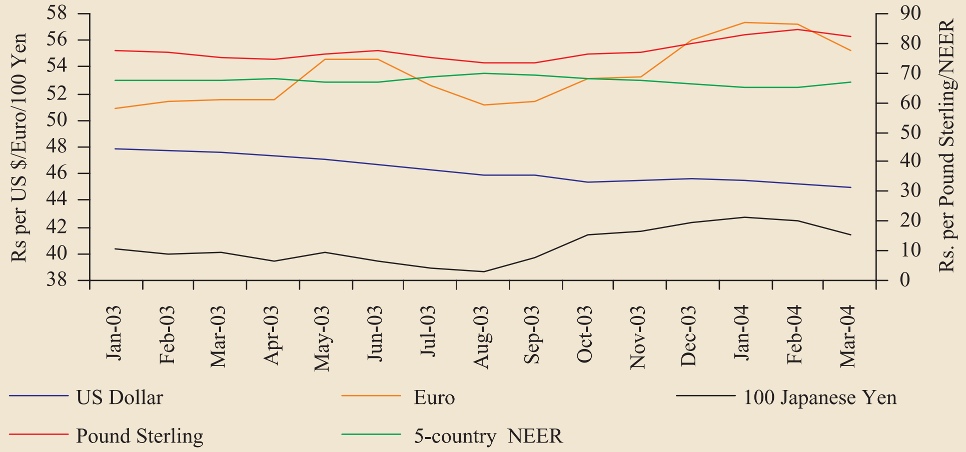


The rest of the money market segments also witnessed increased activity. The market for forward rate agreements and interest rate swaps (FRA/IRS) experienced a sharp expansion during the year with the outstanding amount increasing by about 112 per cent to Rs.5,18,260 crore. The Collateralised Borrowing and Lending Obligation (CBLO), a money market instrument operationalised through the Clearing Corporation of Indian Limited (CCIL) since January 20, 2003, recorded an increase in average daily turnover from Rs.47 crore in April 2003 to Rs. 2,506 crore in March 2004. This market is expected to see further growth with real-time connectivity between the Public Debt Office of the Reserve Bank and CCIL in place and value-free transfer of securities operationalised for CBLO.

Foreign Exchange Market

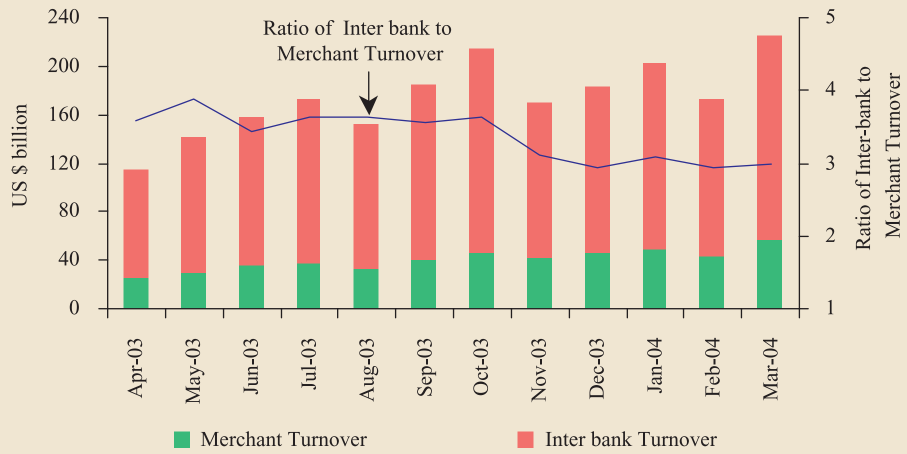
The foreign exchange market was characterised by persistent conditions of excess supply during 2003-04 on account of sustained foreign exchange inflows. In spite of rising demand for imports and large outflows in the capital account due to debt repayments, the Indian rupee appreciated by 9.3 per cent against the US dollar during the year. The rupee, however, weakened against other major currencies. Accordingly, the five-country trade-weight based nominal effective exchange rate (NEER) remained broadly stable at the March 2003 level (Chart 41). Uncertain market sentiments were reflected in intra-week volatility in April 2004 despite ample supply conditions. The rupee depreciated by 2.1 per cent against the US dollar but appreciated by 0.7 per cent against the euro and 3.4 per cent against the yen during the month.

Chart 41 : Indian Rupee *vis-a-vis* Major International Currencies

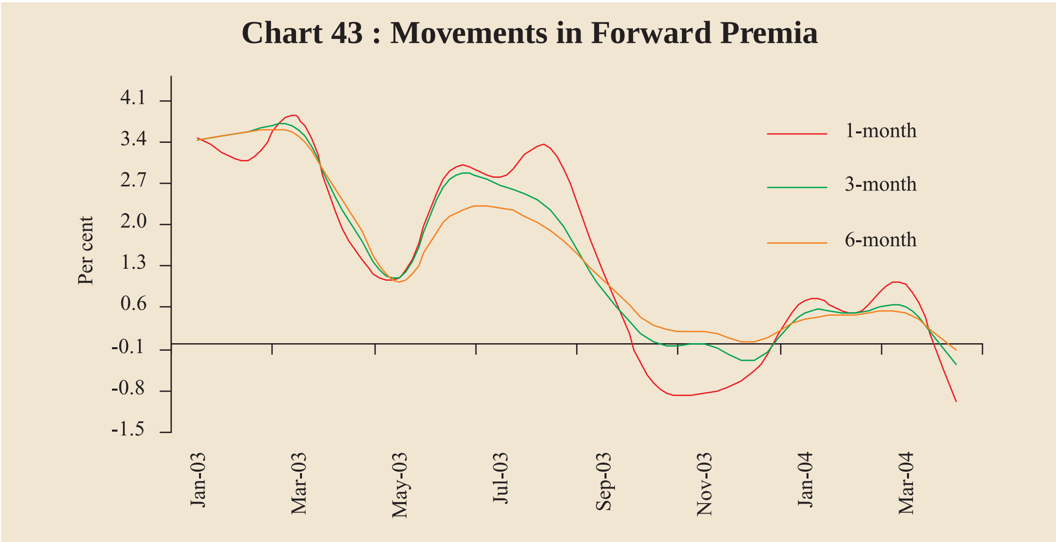


Activity in both the merchant and inter-bank segment of the foreign exchange market increased strongly. While the merchant turnover increased from US $ 25 billion in April 2003 to US $ 56.6 billion in March 2004, the inter-bank turnover increased from US $ 89.4 billion to US $ 168.4 billion during the same period (Chart 42). The ratio of inter-bank to merchant turnover hovered in the range of 3-4, indicating normal hedging activity and stability in exchange rate expectations.

Chart 42 : Turnover in the Foreign Exchange Market



The rupee's upward drift against the US dollar in the spot exchange market drove banks, exporters and corporates to book heavy forward US dollar sales. As a result, forward premia declined sharply over the year turning into discounts on the US dollar during the period October-December 2003. Forward premia turned positive in January and February 2004 with the gradual easing of pressure in the cash market. In March forward premia were generally below one per cent across the maturity spectrum as against a range of 3.5-3.8 per cent during March 2003. Large capital inflows pushed down the forward premia again into slender discounts of around one per cent in April 2004 (Chart 43).



Credit Market

In view of easy liquidity conditions and lower market interest rates, public sector banks (PSBs) reduced deposit rates in the one-year and above tenor from a range of 5.25-7.00 per cent in March 2003 to 5.00-5.75 per cent by April 16, 2004 (Table 18). Deposit rates of the private and foreign banks also eased but the decline in banks' prime lending rate (PLR) was relatively muted.

Table 18 : Deposit and Lending Rates

(Per cent)

	March 2003	June 2003	September 2003	December 2003	March 2004#
1	2	3	4	5	6
1. Domestic Deposit Rate					
Public Sector Banks					
Up to 1 Year	4.00-6.00	4.00-5.75	3.75-5.50	3.75-5.25	3.75-5.25
>1-3 Years	5.25-6.75	5.00-6.25	4.75-6.00	5.00-5.75	5.00-5.75
>3 Years	5.50-7.00	5.25-6.50	5.25-6.25	5.25-6.00	5.25-6.00
Private Sector banks					
Up to 1 Year	3.50-7.50	3.00-7.00	3.00-7.00	3.00-6.25	3.00-6.00
>1-3 Years	6.00-8.00	5.50-7.75	5.50-7.50	5.00-7.00	5.00-6.50
>3 Years	6.00-8.00	6.00-8.00	5.75-8.00	5.50-7.00	5.25-7.00
Foreign banks					
Up to 1 Year	3.00-7.75	3.00-7.75	3.00-7.75	2.75-7.75	2.75-7.75
>1-3 Years	4.15-8.00	3.50-8.00	3.50-8.00	3.35-8.00	3.30-8.00
>3 Years	5.00-9.00	4.50-8.00	3.75-8.00	3.50-8.00	3.25 – 8.00
2. Prime Lending Rate#					
Public sector Banks	9.00-12.25	9.00-12.25	9.00-12.25	9.00-12.25	10.25-11.50
Private Sector Banks	7.00-15.50	7.00-15.50	8.00-15.50	7.50-15.50	10.50-13.00
Foreign Banks	6.75-17.50	5.45-17.50	4.80-17.50	4.55-17.50	11.00-14.85
3. Actual Lending Rates*					
Public sector Banks	6.00-16.25	5.00-16.00	5.75-16.00	5.75-16.00	NA
Private Sector Banks	5.18-23.00	4.95-23.00	3.00-23.00	3.00-23.00	NA
Foreign Banks	5.40-20.00	5.00-23.00	5.00-22.00	3.00-22.00	NA

* Interest rate on non-export demand and term loans above Rs.2 lakh excluding lending rates at the extreme 5 per cent on both sides.

\# Benchmark PLR/ PLR for March 2004.

Sub-PLR lending of the banking system (excluding exports, the bulk of which is at sub-PLR) constituted about half of the total outstanding advances above Rs.2 lakh. The spreads around PLRs of PSBs for term loans (excluding 5 per cent of the credit sanctioned at extreme rates on either side of lending) narrowed marginally during September-December 2003.

During the period March 2003 and March 2004, the range of benchmark PLRs (BPLR) at their upper limits was moderated by 75-265 basis points from the existing PLRs, partly as a result of the introduction of the benchmark concept. As per the information available, nearly all banks have adopted BPLRs on April 1, 2004 by abandoning the system of tenor linked PLR. During January to March 2004, the range of BPLRs was 10.25-14.85 per cent. The level of BPLRs continued unchanged in April 2004.

Food credit extended by the banking system declined in consonance with lower procurement. Non-food credit picked up in the second half of 2003-04, driven up by credit to the priority sector, retail credit and export credit. The main driver of credit within the priority sector were 'other priority sectors' and agricultural credit. Credit to housing picked up in 2003-04 primarily on account of policy incentives and lower interest rates. Credit to medium and large industry and wholesale trade recorded lower growth (Table 19).

Table 19 : Deployment of Bank Credit

(Rupees crore)

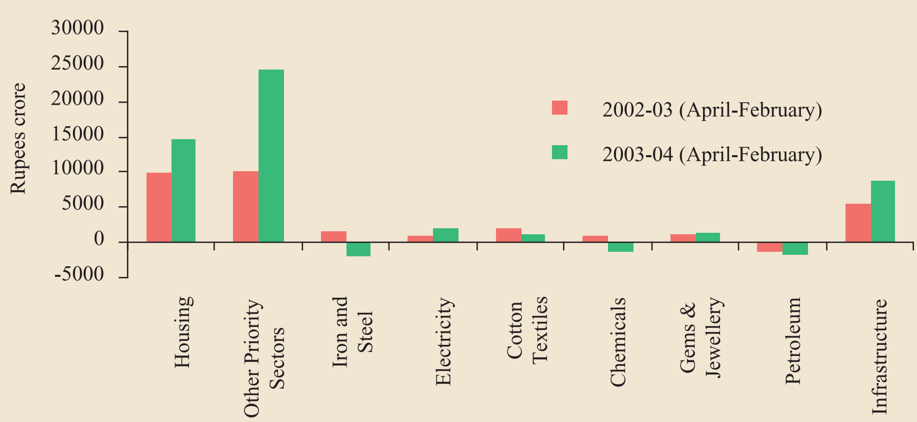
Sector/Industry		2002-03 Up to February		2003-04 Up to February	
		Absolute	Per cent	Absolute	Per cent
1		2	3	4	5
1 Priority sector#		19,548	11.2	39,076	18.5
	Agriculture	7,424	12.2	11,001	15.0
	Small Scale	2,119	3.7	3,500	5.8
	Others	10,005	17.5	24,575	31.6
2 Industry	(Medium and Large)	22,070	12.8	6,807	2.9
	Iron and Steel	1,479	7.4	-1,896	-6.8
	Electricity	1,008	10.8	2,057	18.4
	Cotton Textiles	2,072	17.6	1,040	6.6
	Chemicals, Dye, Paints	839	3.2	-1,175	-3.7
	Gems and Jewellery	1,219	18.9	1,378	18.3
	Petroleum	-1,331	-11.8	-1,648	-11.2
	Infrastructure	5,466	36.9	8,731	33.2
3 Housing		9,974	44.6	14,774	40.4
4 Non-Banking Financial Companies		2,914	30.2	625	4.4
5 Wholesale Trade		2,192	10.7	1,132	5.0
6 Export Credit		3,710	8.6	6,236	12.7

Variations: columns 2–5.

Excluding investments in eligible securities.
Note: Data are provisional and relate to select scheduled commercial banks which account for about 90 per cent of bank credit of all scheduled commercial banks.

Petroleum, chemicals and iron and steel industries recorded a decline in bank credit demand. On the other hand, gems and jewellery and infrastructure recorded a healthy growth in credit off-take (Chart 44). The decline in overall credit to industry during April 2003 to February 2004 can be attributed, *inter alia*, to an increased recourse by corporates to internal sources of financing enabled by higher profits as well as surge in debt issues in the private placement market and higher external commercial borrowings.

Chart 44 : Credit to Major Industries



Operational and prudential indicators for the banking system point to a growing resilience. Commercial bank profitability continued to increase during 2003-04. Both gross NPA to gross advances and net NPA to net advances ratios were lower during the first half of 2003-04 than in the corresponding period of 2002-03 (Table 20). By end-September 2003, banks had recovered Rs. 769 crore from 13,583 cases out of an aggregate amount outstanding of Rs.14,141 crore in 42,047 cases.

Table 20 : Important Parameters of Scheduled Commercial Banks

(per cent)

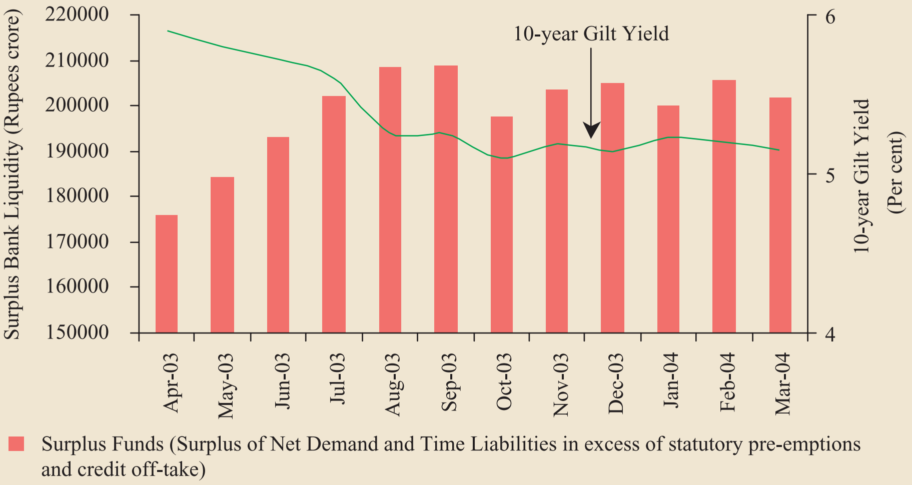
Parameter	March 2003	April-September #	
		2003-04	2002-03
1	2	3	4
Operating Expenses/Total Assets	2.2	1.1	1.1
Spread/Total Assets	2.8	1.5	1.5
Net Profits/Total Assets	1.0	0.6	0.5
Gross Non-Performing Assets to Gross Advances	8.8	9.7	11.1
Net Non-Performing Assets to Net Advances	4.4	4.0	5.5
CRAR	12.6	13.2	12.5

#Data relate to domestic operations only.

Government Securities Market

Average monthly volumes of secondary market transactions in Government securities through the subsidiary general ledger (SGL) increased sharply to Rs.2,19,991 crore during 2003-04 as against Rs.1,61,804 crore during 2002-03. Ample liquidity conditions enabled reduction in yields in the Government securities market during the first half of 2003-04. As non-food credit off-take began to recover, market sentiment limited the softening of the yields during the second half of the year (Chart 45).

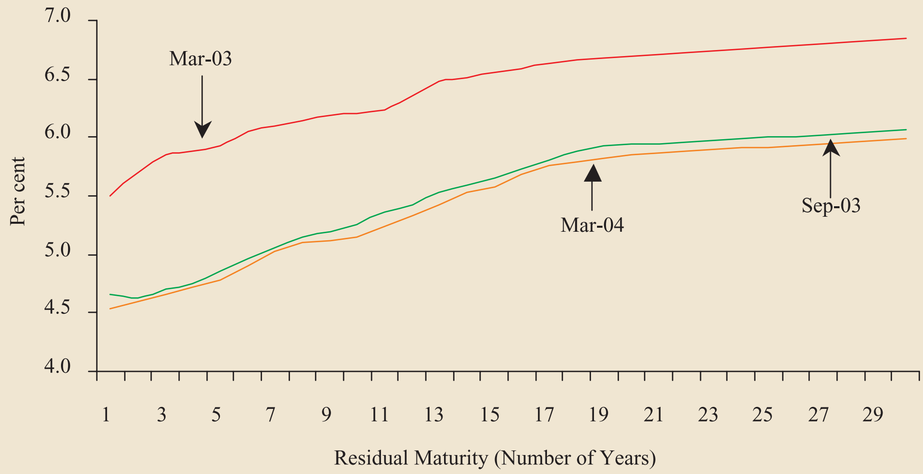
Chart 45 : Surplus Bank Liquidity and Interest Rates



Liquidity conditions facilitated a smooth completion of the borrowing programme of the Central Government, which was truncated by a persistent cash surplus in its current account since August 8, 2003. The weighted average cost of market borrowing through issuances of dated securities declined to 5.74 per cent during 2003-04 from 7.34 per cent in 2002-03. The weighted average maturity increased to 14.94 years from 13.83 years. The first ever buy-back auction through an interactive platform developed by CCIL enabled the market to return 19 high coupon but relatively illiquid Government securities amounting to a total face value of Rs.14,434 crore in exchange for four liquid securities involving a buy back premium of Rs.3,472 crore paid by the Government. There were three issuances of Floating Rate Bonds aggregating Rs.16,000 crore.

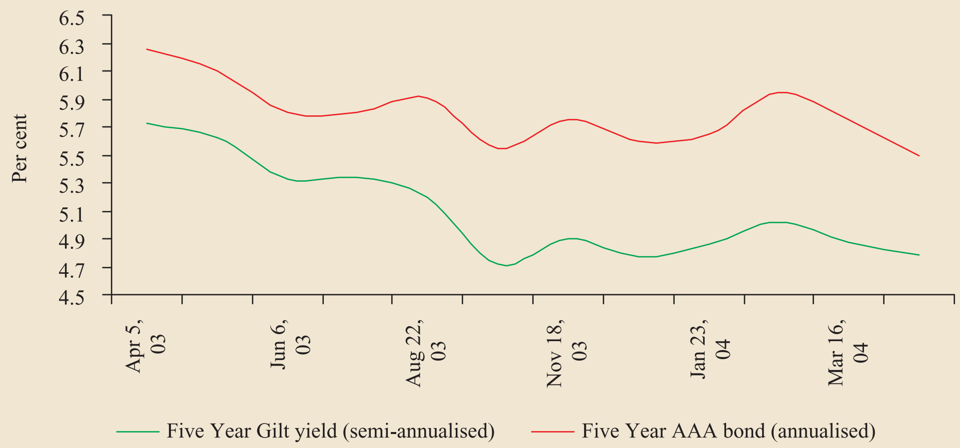
The yield curve flattened in the secondary market for Government securities during the first half of 2003-04. Despite intermittent price rallies under easy liquidity conditions, gains were capped as the market borrowing programme of the Government intensified and open market sales were conducted. The repo rate reduction, effective August 25, 2003, boosted market sentiment with the 10-year yield declining to 5.23 per cent on August 26, 2003. The announcement of the calendar of issuance of Government securities for the second half of 2003-04 was much lower than the anticipated amount. Market sentiment lifted, leading to a fall in yields across short to medium-tenor securities at the end of the second quarter of 2003-04 (Chart 46).

Chart 46 : Yield Curves for Central Government Dated Securities



In the second half of 2003-04, inflation expectations hardened at the long end of the maturity spectrum. The lowering of cut-off yields on 364-day Treasury Bills drove down the 10-year yield on Government securities to a low of 4.95 per cent on October 16, 2003. Open Market Operation (OMO) sales and a series of 28-day repos under the LAF in the second fortnight of October checked possible rallies. As portfolio switches occurred, the outright transactions in Central Government securities, which had moved up from Rs.1,13,402 crore in April 2003 to Rs.1,94,984 crore in August 2003, decreased to Rs.90,810 crore in January 2004. With liquidity at high levels, yields inched down in March 2004. During the year, the 10-year yield declined by 106 basis points from 6.21 per cent at the end of March 2003 to 5.15 per cent at the end of March 2004. Yields moved up for securities of tenor of 14 year and above by around 13 basis points on an average and by seven basis points for tenors between four year and 10 year. The larger than expected drop in inflation boosted demand for securities at the longer end causing the yield curve to flatten in March 2004. Yield spreads between Government securities and AAA-rated corporate bonds widened marginally during the latter half of the year (Chart 47).

Chart 47 : Yield Spreads

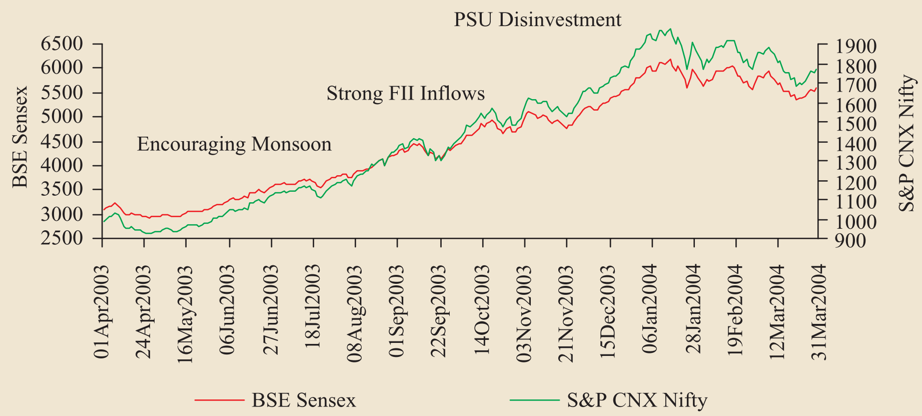


The Government securities market remained bullish in April 2004 amidst ample liquidity conditions with the 10-year yield hovering around 5.14 per cent at the end of the month. The yield curve flattened as the supply of securities increased at the short end while excess demand prevailed at the long end.

Equity Market

The stock markets broke out of the subdued conditions prevailing since February 2000 in a sustained upturn from the end of May 2003. The BSE Sensex crossed the 6100 mark in January 2004 in a strong rally (Chart 48). The BSE Sensex had crossed the 6000 mark only once before in intra-day trading during February 2000. Intermittent bouts of correction occured since February 2004. Notwithstanding the correction on profit booking at higher levels, the underlying macroeconomic fundamentals continued to be strong. The average BSE-Sensex during April 2004 worked out to 5809.

Chart 48 : Indian Stock Markets - 2003-04



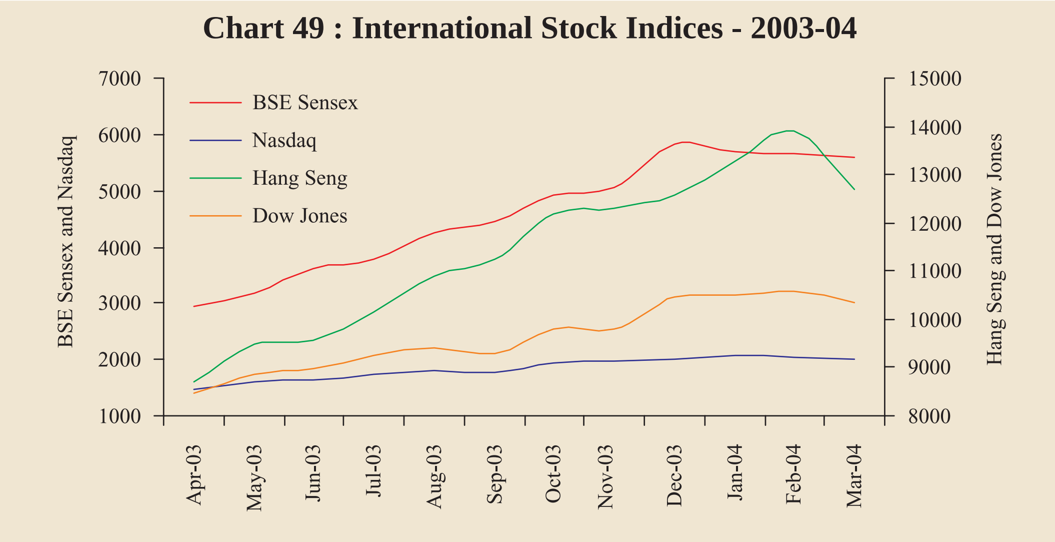
The increase in stock prices was accompanied by a rise in market capitalisation, turnover and volatility (Table 21).

Table 21: Stock Market Indicators

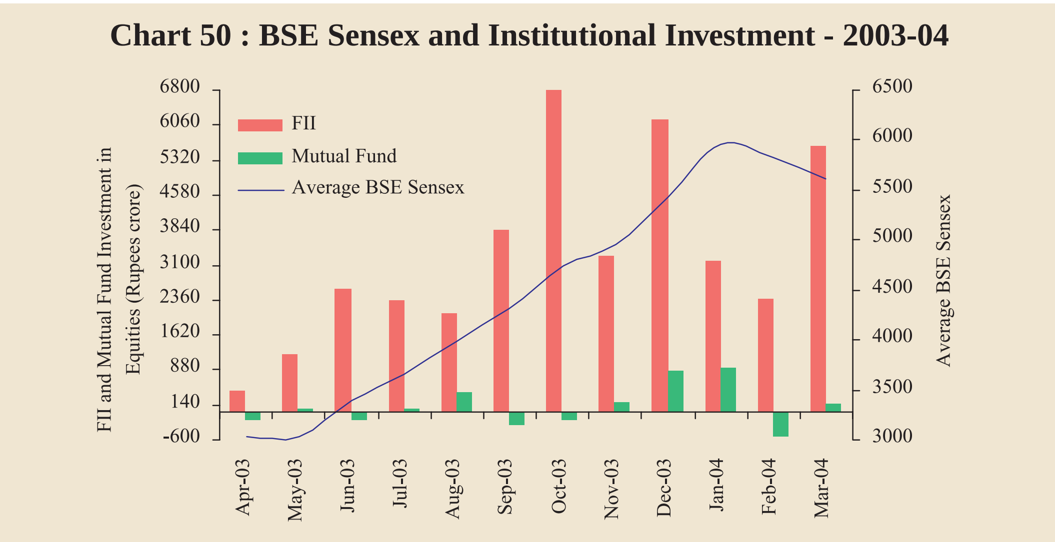
Indicator	BSE		NSE	
	2003-04	2002-03	2003-04	2002-03
1	2	3	4	5
Average BSE Sensex/ S&P CNX Nifty	4492.19	3206.29	1427.50	1037.23
Volatility (Coefficient of Variation) (Per cent)	22.95	4.85	23.30	5.17
Turnover (Rupees crore)	5,02,618	3,14,073	10,99,535	6,17,988
Market Capitalisation (end-period) (Rupees crore)	12,01,207	5,72,197	11,20,976	5,37,133

Source: The Stock Exchange, Mumbai (BSE) and National Stock Exchange (NSE).

The rally in 2003-04 was stronger and more broad-based than in 1999-2000. It was supported by an improvement in underlying fundamentals, strong corporate performance, a robust appetite of Foreign Institutional Investors (FIIs) for Indian equity and debt instruments as well as sector-specific factors. The revival of the stock market in India was coincident with a return of buoyancy to equity markets worldwide (Chart 49).

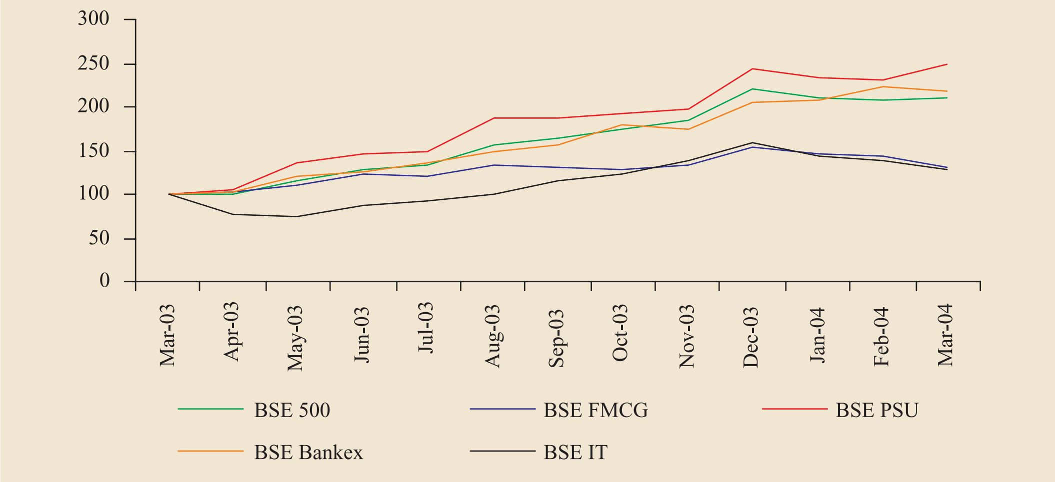


Foreign Institutional Investors (FIIs) made net investments in equity amounting to Rs.39,959 crore during 2003-04 as compared with Rs.2,528 crore during 2002-03 (Chart 50). Notably, mutual funds made net investments in equity amounting to Rs.1,308 crore during 2003-04 as compared with net sales of Rs.2,067 crore in 2002-03.



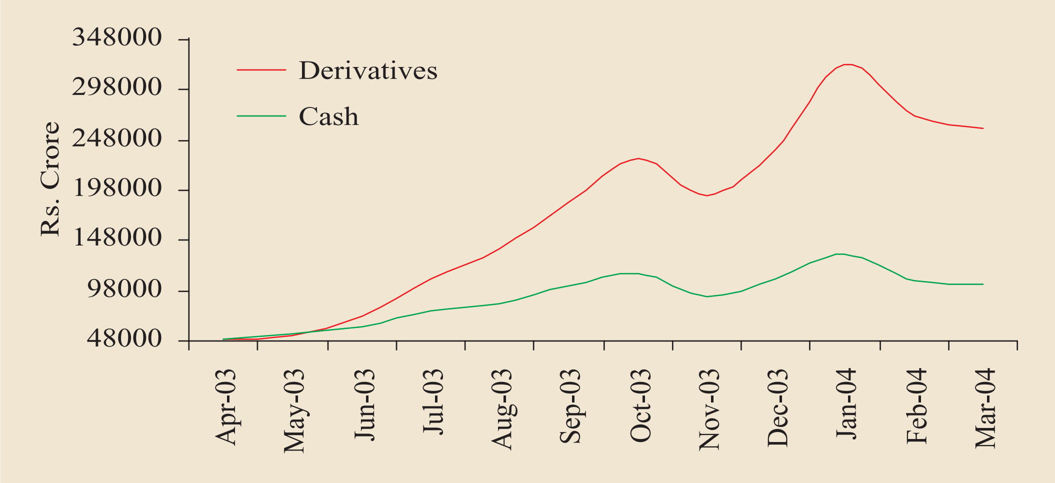
The rally in the stock market was broad-based with the BSE 500 index registering an increase of 109.4 per cent during 2003-04 as against a decline of 8.0 per cent during the preceeding year. Technology, banking, fast moving consumer goods (FMCG) stocks contributed to the rally (Chart 51).

Chart 51 : Sectoral Equity Indices - 2003-04



The derivative segment continued to expand with the total turnover on the NSE derivatives segment rising nearly five-fold to Rs.21,30,612 crore during 2003-04 from Rs.4,39,863 crore during 2002-03. The cash segment turnover recorded an increase, but this was modest in comparison with the derivatives market (Chart 52). In addition to stock futures and options and index futures and options, interest rate futures were introduced on the NSE, effective June 2003.

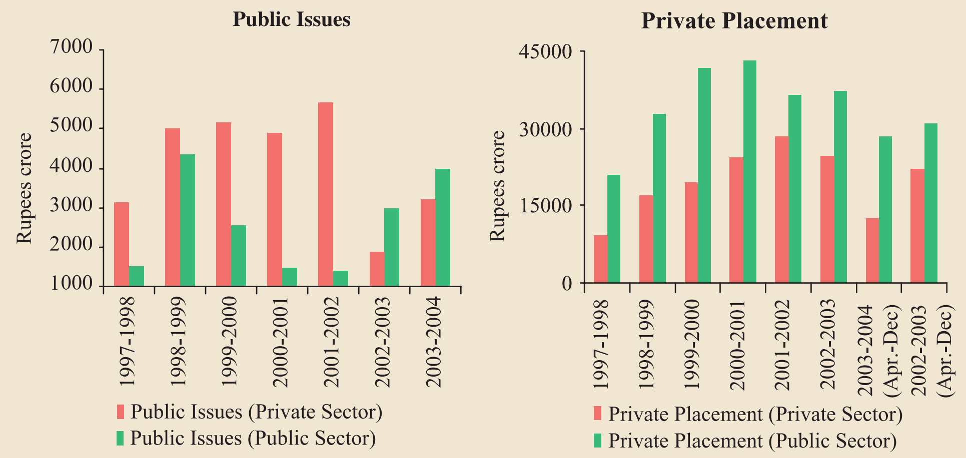
Chart 52 : Turnover in NSE's Cash and Derivatives Markets - 2003-04



Primary Market

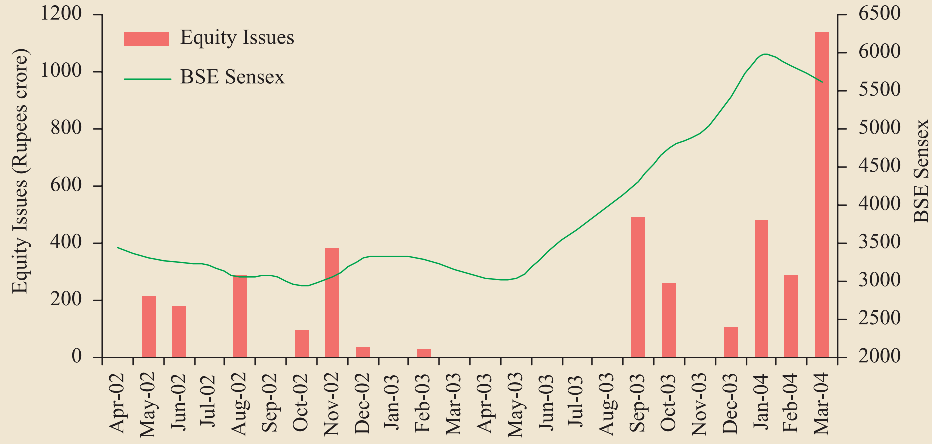
After a long period of lacklustre activity, the public issues market experienced a revival. Resource mobilisation in the public issues market (excluding offers for sale) amounted to Rs.7,190 crore through 35 issues during 2003-04, as against only Rs.4,867 crore raised through 17 issues during 2002-03 (Chart 53). Out of the issues floated in 2003-04, 28 were equity issues accounting for 40.5 per cent of resource mobilisation. Public sector entities accounted for 55.4 per cent of total resources mobilised in the primary market.

Chart 53 : Resource Mobilisation in Primary Market



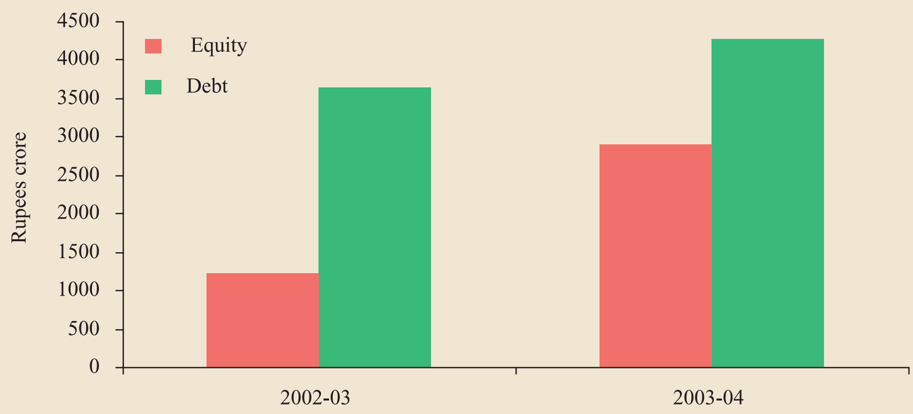
Non-Government public limited companies (private sector) garnered Rs.3,210 crore through 27 issues during 2003-04 as compared with Rs.1,878 crore raised through nine issues during the previous year. In 2003-04, 24 equity issues aggregated to Rs.1,959 crore as compared with five equity issues aggregating Rs.460 crore during the previous year. Equity issances surged during the second half of 2003-04 (Chart 54). There were three debt issues of Rs.1,251 crore (all from ICICI Bank) during 2003-04 as compared with four bond issues of Rs.1,418 crore during 2002-03.

Chart 54 : Equity Issues and BSE Sensex



Public sector entities mobilised Rs.3,980 crore through eight issues during 2003-04 as compared with Rs.2,989 crore raised through eight issues during the previous year. Four public sector banks floated equity issues aggregating Rs.950 crore during 2003-04. All-India Financial Institutions floated three bond issues of Rs.2,930 crore (all from IDBI) during 2003-04 as compared with five bond issues aggregating Rs.2,216 crore during the previous year (Chart 55).

Chart 55 : Public Issues – Instrument-wise



Resource mobilisation through private placement aggregated Rs.41,070 crore during April-December 2003, down from Rs.53,308 crore mobilised during the corresponding period of the previous year (see Chart 53). 131 entities entered the market in 2003-04 with 669 floatations as compared with 148 entities with 912 floatations during the corresponding period of the preceeding year. All the issues in the private placement market were debt issues excepting one equity issue. The public sector entities (mainly financial intermediaries) dominated the private placement market; however, resource mobilisation by these entities decreased marginally to Rs.28,372 crore. Public sector entities accounted for 69.0 per cent of total resource mobilisation in the private placement market as compared with 58.2 per cent in the corresponding period of the previous year.

A total of eighteen issues aggregating Rs.3,098 crore (US$ 666 million) were floated in the Euro issues market during 2003-04 as compared with eleven issues aggregating Rs.3,426 crore (US$ 711 million) during the previous year. GDR issuances recorded a sharp decline.

The resource mobilisation by mutual funds (net of redemptions) amounted to Rs.46,808 crore during 2003-04, a sharp increase of 1015.5 per cent over the preceding year. UTI recorded a net inflow of Rs.1,667 crore during 2003-04 as compared with a net outflow of Rs.9,434 crore during the previous year. The resources mobilised by private sector mutual funds increased to Rs.42,545 crore (Rs.12,069 crore in 2002-03). Public sector mutual funds mobilised Rs.2,597 crore (Rs.1,561 crore in 2002-03).

Financial assistance sanctioned and disbursed by All-India Financial Institutions increased sharply during 2003-04 to Rs.52,924 crore and Rs.31,457 crore, respectively, after a gap of more than two years.

VI. The External Economy

India's external sector gained strength and resilience during the year. The current account balance remained in surplus for the third consecutive year, despite a surge in imports. Merchandise export growth was significantly higher than the annual target of 12 per cent and was accompanied by an acceleration in the growth of invisible earnings. Net capital flows during 2003-04 were the highest ever in spite of substantial pre-payments of bilateral and multilateral debt, Resurgent India Bonds (RIBs) redemption and lending to the IMF. The rising international investor confidence in the Indian economy was reflected in a surge of portfolio investment and revision of international credit ratings to investment grade, after a hiatus of around seven years. At the end of March 2004, India's foreign exchange reserves (excluding gold) were the fifth largest among the emerging market economies and the sixth largest in the world (Chart 56).

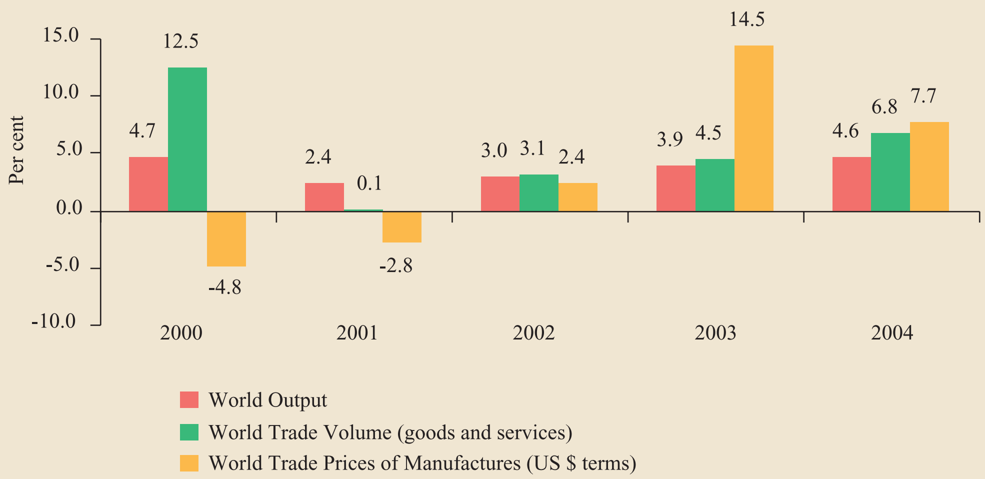
Chart 56 : Outstanding Foreign Exchange Reserves

Note : For Mexico, Brazil, Malaysia and Thailand data relate to February 2004.

International Developments

Signs of global recovery firmed up during 2003. In the US, economic activity was buoyed up by monetary and fiscal stimuli and aided by productivity gains. In the UK, output growth was above trend in the second half of 2003. The Asia-Pacific region continued to be the fastest growing region in 2003, led by China and India. In Japan, GDP rose in all quarters of 2003. The fourth quarter recorded a significant step-up of growth to 6.4 per cent (annualised) as domestic demand was augmented by exports. Activity in the euro area remained weak, held down by sluggish domestic demand. According to the IMF, global GDP growth is estimated to have increased from 3.0 per cent in 2002 to about 3.9 per cent in 2003 (Chart 57). World trade prices in US dollar terms recovered sharply, essentially reflecting depreciation of the US dollar against major international currencies and an upturn in the cycle for global commodity prices.

Chart 57 : Growth in World Output and Trade

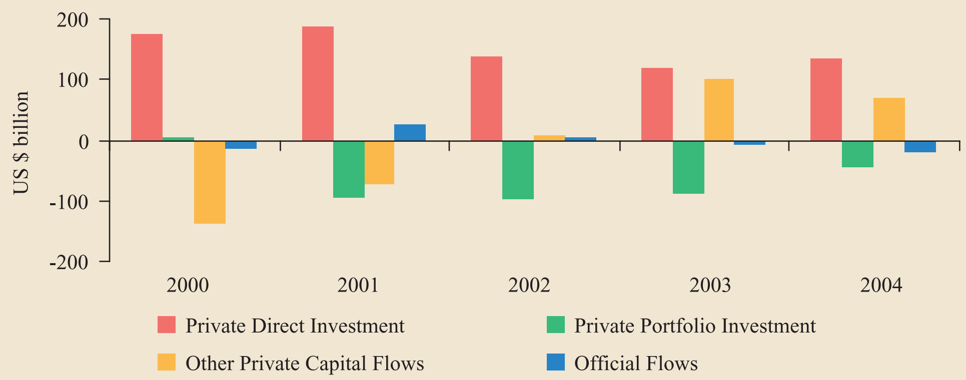


Note: Data for 2004 are IMF projections.
Source: World Economic Outlook, IMF, April 2004.

In advanced economies, long-term interest rates touched 40-year lows by mid-June 2003 reflecting the accommodative stance of monetary policy. In subsequent months, long-term rates increased in some countries such as the USA on signs of a pick-up in activity. Equity markets remained buoyant, benefiting from earnings growth, with many emerging markets posting double-digit gains. Improved domestic growth prospects coupled with low policy rates in advanced economies made emerging markets attractive to foreign investors. Sentiment towards emerging market economies (EMEs) was also boosted by a series of credit rating upgrades, mainly reflecting fiscal consolidation and increasing foreign exchange reserves. The upgrades were associated with narrowing down of spreads on bonds of most of the EMEs. Concerns about the US current account deficit weighed down on the US dollar which witnessed a cumulative depreciation by 16.5 per cent since September 2003.

Private capital flows to EMEs increased significantly during 2003, mainly on account of a marked rise in 'other' capital flows and a marginal decline in outflows under portfolio investment. On the other hand, direct investment inflows declined (Chart 58).

Chart 58 : Net Capital Flows to EMEs



Note: Data for 2004 are IMF projections.
Source: World Economic Outlook, IMF, April 2004.

According to the IMF, global GDP growth is estimated to increase further to 4.6 per cent in 2004. This assessment is based on expectations of a reduction in geo-political uncertainties, policy stimulus in the pipeline and a gradual diminution of the after effects of the stock market bubble. The major risks to sustaining the recovery emanate from the imbalances arising out of the twin deficits of the US economy and the consequent possibility of a disruptive adjustment of the US dollar against the major currencies. In turn, these risks pose dangers of abrupt or unexpected increases in interest rates which could stifle investment and consumption and increase debt servicing.

Merchandise Trade

According to the Directorate General of Commercial Intelligence and Statistics (DGCI&S), India's merchandise exports posted a growth of 17.1 per cent during 2003-04 benefiting from improved external demand conditions, the firming up of manufacturing activity domestically and favourable shifts in the policy mix for the external sector. The depreciation of the US dollar *vis-a-vis* other international currencies was reflected in a modest improvement in unit value realisation even as the volume growth of exports slowed relative to the preceding years.

The export performance was underpinned by a strong growth in engineering goods, chemicals and related products and petroleum products. Exports of engineering goods accelerated with contributions from all major constituents – iron and steel, machinery, automobiles and electronic goods. The automobile sector emerged as a leading exporter, attesting to the rising technology content of India's exports. Indian steel exporters turned out to be among the lowest cost producers in the world. On the other hand, exports of traditional manufactured items such as textiles posted a decline.

The decline in primary products was mainly in respect of traditional items (tea, *basmati* rice, spices, cashew, marine products and ores and minerals). Within primary products, the export basket is undergoing shifts. Exports of non-traditional items (fresh fruits and vegetables, wheat, dairy products, processed vegetables and poultry products) showed a sharp increase (Table 22).

Table 22 : Merchandise Exports: April-December

Commodity Group	US $ million		Variation (per cent)	
	2002-03	2003-04	2002-03	2003-04
1	2	3	4	5
1. Primary Products	6,459	6,393	25.1	-1.0
2. Manufactured Goods	29,206	33,291	21.3	14.0
Of which:				
a. Chemicals and Related Products	5,445	6,452	23.5	18.5
b. Engineering Goods	6,415	8,418	26.7	31.2
Of which:				
Metals	1,365	1,645	14.2	20.5
Machinery and Instruments	1,487	1,928	19.8	29.7
Transport Equipments	893	1,327	25.6	48.5
Iron and Steel	1,200	1,668	80.3	39.0
Electronic Goods	917	1,222	2.8	33.3
c. Textiles	8,044	7,958	13.8	-1.1
d. Gems and Jewellery	6,531	7,789	31.1	19.3
3. Petroleum Products	1,687	2,473	7.3	46.6
4. Total Exports	**38,066**	**43,523**	**19.9**	**14.3**

Source: DGCI&S.

In terms of destinations, Asian countries continued to record a robust growth although at a more moderate pace than in 2002-03. Absorption was lower in key markets such as the US and Japan. Export growth to European Union was broadly of the same order as in the previous year.

Merchandise imports recorded a sharp rise of 25.3 per cent in US dollar terms during 2003-04. This was mainly on account of a surge in non-oil imports, reflecting the pick-up in industrial activity. Oil imports increased sharply due to hardening of international crude oil prices from an average of US $ 27.6 per barrel in 2002-03 to US $ 29.1 per barrel in 2003-04 as well as shortfalls in domestic crude production. Rising domestic demand for capital goods, industrial raw materials and intermediate goods boosted non-PoL import growth, which again is symptomatic of the resurgence in industrial activity. Imports of gold and silver increased sharply, partly reflecting a base effect (these imports had declined in the corresponding period of the previous year) (Table 23). As regards the geographical distribution of imports, Asia emerged as the key source followed by the USA and Japan.

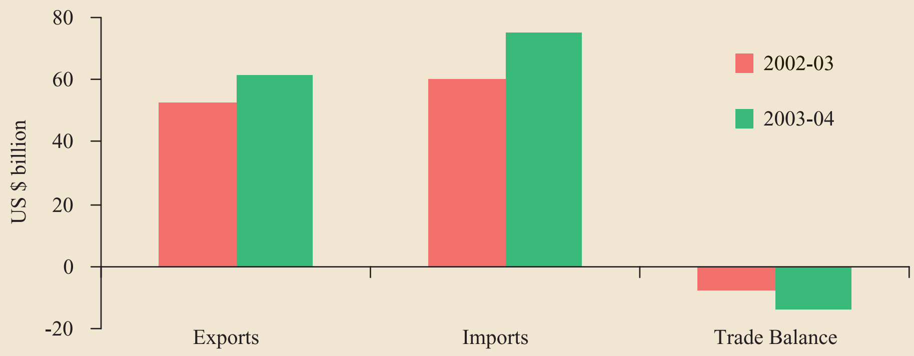
Table 23 : Merchandise Imports: April-December

Commodity Group	US $ million		Variation (per cent)	
	2002-03	2003-04	2002-03	2003-04
1	2	3	4	5
1. POL	12,768	14,706	19.0	15.2
2. Edible Oils	1,330	1,932	25.3	45.3
3. Iron and Steel	708	1,072	16.8	51.6
4. Capital Goods	9,057	12,185	33.9	34.5
5. Pearls, Precious and Semi-Precious Stones	4,504	5,005	40.3	11.1
6. Chemicals	2,221	2,859	6.7	28.8
7. Gold and Silver	3,455	4,961	-12.4	43.6
8. Total Imports	**44,553**	**55,432**	**15.8**	**24.4**
Memo:				
Non-oil imports excluding gold and silver	28,329	35,765	19.0	26.2

Source: DGCI&S.

India's trade deficit, based on DGCI&S data, nearly doubled to US $ 13.7 billion during 2003-04 driven up by the expansion in imports (Chart 59).

Chart 59 : India's Merchandise Trade



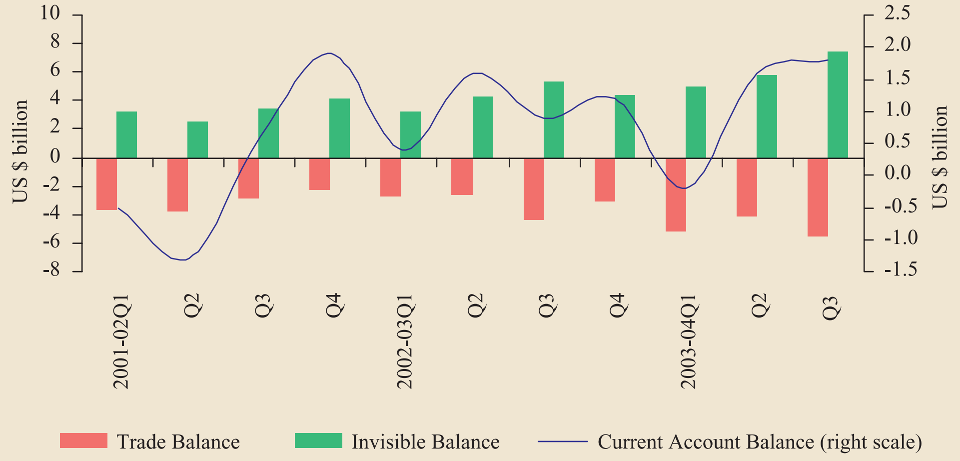
Source: DGCI&S

Invisibles and Current Account

As in the preceding two years, the invisible surplus was able to fully offset the merchandise trade deficit. The surplus in the invisible account increased from US $ 12.6 billion in April-December 2002 to US $ 18.2 billion in April-December 2003, mainly on account of higher receipts from software services, private transfer receipts and tourism earnings. A revival of international interest in India as a tourist destination was reflected in an increase of 18.5 per cent in tourist arrivals in 2003-04. Exports of software and IT-enabled services have been growing at an average rate of 46 per cent since the mid-1990s. Despite the global slowdown, Indian IT industry raised its share in global IT-spending from about one per cent at the end of the 1990s to about three per cent currently. India is one of the most preferred destinations for outsourcing of IT services.

With buoyant invisible receipts, the current account surplus increased to US $ 3.2 billion during April-December 2003 from US $ 2.9 billion during the corresponding period of the previous year (Chart 60).

Chart 60 : Current Account Balance



Capital Account

In the capital account, there were unprecedented two-way movements. Foreign institutional investors displayed a strong appetite for India *vis-a-vis* other EMEs, drawn by attractive valuations (Table 24). Portfolio investment inflows turned out to be the highest in any year since the opening of Indian stock exchanges to FIIs in 1992-93. Equity investments continued to be the pre-dominant component; however, FII investment in debt instruments rose strongly too, exceeding the cap of US $ 1 billion in 2003-04, an all-time peak. Issuances by Indian corporates in overseas stock exchanges were subdued in relation to 2002-03, with a preference for convertible bonds over depository receipts.

Table 24 : Foreign Portfolio Investment Flows

(US $ billion)

Country	Portfolio Inflows			Price-Earnings
	2001	2002	2003	Ratio (Per cent)
1	2	3	4	5
Hong Kong	-1.2	-0.9	-1.4	17.8
Chile	1.4	1.3	1.0	18.6
India	2.0	1.0	11.4	14.3
South Korea	12.2	4.9	14.2	14.6
Philippines	1.4	2.3	1.1	16.8
Thailand	-0.6	-0.7	0.3	9.0

Note: 1. Data for China, Chile, Hong Kong and Philippines for 2003 are up to September and for Thailand up to June.
2. Data for price-earnings ratio are for end-March 2004.
3. Data for India relates to financial year.

During 2003-04, foreign direct investment into India at US $ 4.5 billion fell marginally short of the previous year's level of US $ 4.7 billion. The services sector was the largest recipient of FDI inflows. Mauritius remained the largest source of FDI flows to India followed by the USA, the Netherlands and the UK.

Non-resident Indians (NRIs) also shared in the international investor confidence in India. During 2003-04, net inflows into NRI deposit schemes at US $ 3.6 billion surged above US $ 3.0 billion recorded in 2002-03. RIB redemptions produced one-off effects in October 2003 as switches into deposit accounts occurred. Thereafter, net inflows slowed down to an average of US $ 55 million per month as further reduction in the interest rate ceiling on NRE scheme to LIBOR *plus* 25 basis points in October 2003 (and to LIBOR only effective April 17, 2004) took effect. Other banking capital was lower at US $ 2.1 billion during April-December 2003 as compared with US $ 4.4 billion during the corresponding period of the previous year. The build-up of banks' overseas foreign currency assets and borrowings in the first half of the year on account of RIB redemption was partly offset by a subsequent drawdown.

Medium- and long-term debt flows were impacted by pre-payments of official debt (US $ 2.0 billion) and redemption of RIBs (US $ 5.2 billion) till end-December 2003. There was a further pre-payment of official debt of US $ 1.8 billion during January-March 2004. As a consequence, net outflows were recorded under external assistance and external commercial borrowings, despite some pick-up in demand for ECBs in line with stronger industrial activity and interest rate differentials (Table 25).

Table 25 : Capital Flows: April-December

(US $ billion)

Item	2002-03	2003-04
1	2	3
1. Foreign Direct Investment	2.8	2.5
2. Portfolio Investment	0.4	7.6
3. Non-resident (NRI) deposits	2.4	3.5
4. Banking Capital, excluding NRI deposits	4.4	2.1
5. External Commercial Borrowings	-2.0	-3.7
6. Short-term Trade Credits	0.4	2.4
7. External Assistance	0.1	-1.8
8. Total	**10.5**	**17.3**

The surpluses in the capital and current accounts led to an overall balance of payments surplus of US $ 20.8 billion during April-December 2003.

Foreign Exchange Reserves

India's foreign exchange reserves including the reserve position in the IMF stood at US $ 113.0 billion on March 31, 2004, recording an unprecedented accretion of US $ 36.9 billion during 2003-04. The increase in reserves was almost entirely on account of foreign currency assets. The reserve position in the IMF increased by US $ 639 million mainly on account of lendings under the IMF's financial transaction plan. Out of the total RIB redemption of US $ 5.2 billion, US $ 2.8 billion was paid out of the Reserve Bank's forward foreign currency receivables and the balance US $ 2.4 billion out of its foreign exchange reserves. The reserves were also drawn down by pre-payments of official debt, as referred to earlier. Inclusive of reserve position in the IMF, foreign exchange reserves amounted to US $ 118.5 billion at the end of April 2004.

In terms of trade related reserve adequacy indicators, India's foreign exchange reserves at about 17 months of imports are higher than other EMEs in Asia. India's ratio of reserves to short-term debt comfortably satisfies the adequacy criterion *vis-à-vis* comparator countries. In terms of overall external debt and total external liabilities, India's reserves are broadly adequate. As regards the money-based indicators, India is far below the East Asian economies, indicative of the vulnerability of economic activity to any possibility of massive capital outflows. Furthermore, the ratio of India's reserves to GDP is the lowest among the major EMEs of Asia (Table 26).

Table 26 : Reserve Adequacy Indicators

(Per cent)

Criteria	India	China	Korea	Singapore	Hong Kong
1	2	3	4	5	6
*Trade-related Indicators**					
Import cover (months)	17.3	12.8	11.0	9.5	6.4
Current payments cover	13.2	12.4@	8.8	6.4@	5.2
Debt-related Indicators#					
Reserves to external debt	90.8	126.7	77.2	56.9	32.9
Reserves to short-term external debt	1521.7	490.9	280.7	81.1	48.8
Reserves to total external liabilities	46.9	NA	43.3	29.3	16.3
*Money-based Indicators**					
Reserves to broad money	24.2	16.3	35.2	88.3	30.0
Reserves to reserve money	111.0	66.0	478.8	833.0	328.2
Macro Indicators@					
Reserves to GDP	17.6*	23.5	24.1	91.5	69.3

* Data pertain to end-March 2004.
# Data pertain to end-December 2003.
@ Data pertain to end-December 2002.
Source : 1. International Financial Statistics, IMF.
2. Websites of the concerned central banks.

External Debt

India's external debt increased by US $ 7.4 billion (7.1 per cent) during April-December 2003 to reach US $ 112.1 billion at end-December 2003. NRI deposits and short-term debt were the major contributors to the rise in external debt (Chart 61).

Chart 61 : Increase in External Debt by Component

The increase in debt under NRI deposits reflected conversion of maturing non-repatriable deposits (hitherto not part of external debt) into repatriable schemes and their consequent inclusion under external debt. Key indicators pointed to enduring sustainability of external debt (Chart 62).

Chart 62 : Short-term External Debt