Macroeconomic and Monetary Developments

Mid-Term Review 2005-06

Reserve Bank of India
Mumbai

Contents

I. THE REAL ECONOMY

The Indian economy recorded an impressive performance during the first quarter of 2005-06. According to the Central Statistical Organisation (CSO), real GDP growth in the first quarter (April-June) of 2005-06 accelerated to 8.1 per cent from 7.6 per cent in the corresponding period of the preceding year. The improved performance in real activity was propelled by the double-digit growth in industrial activity and robust services sector. Industrial activity was mainly led by the manufacturing sub-sector. The expansion of services sector continued to be spearheaded by the sub-sector 'trade, hotels, restaurants, transport, storage and communication', and supported by 'financing, insurance, real estate and business services' and construction. Real GDP originating from the 'agriculture and allied activities', however, remained subdued reflecting the adverse impact of the uneven monsoon during 2004-05 (Table 1).

Against the backdrop of the economic performance in the first quarter, developments in the real economy during 2005-06 so far covering the agricultural situation, the progress of the South-West monsoon, industrial production, business and investment expectations and the lead indicators of service sector activity are presented in this section.

Table 1: Growth Rates of Real GDP

(Per cent)

Sector	1993-94 to 2002-03 (Average)	2003-04*	2004-05#	2004-05 Q1	2004-05 Q2	2004-05 Q3	2004-05 Q4	2005-06 Q1
1	2	3	4	5	6	7	8	9
1. Agriculture and Allied Activities	**2.1 (26.5)**	**9.6 (21.7)**	**1.1 (20.5)**	**3.8**	**0.0**	**-0.5**	**1.8**	**2.0**
1.1 Agriculture	2.0	10.3	N.A					
2. Industry	**6.6 (22.1)**	**6.5 (21.6)**	**8.3 (21.9)**	**7.6**	**9.1**	**9.2**	**7.3**	**10.1**
2.1 Mining and Quarrying	4.7	6.4	4.5	6.9	4.7	4.5	2.5	3.2
2.2 Manufacturing	7.1	6.9	9.2	7.9	9.6	10.5	8.6	11.3
2.3 Electricity, Gas and Water Supply	5.2	3.7	5.5	6.1	9.1	4.4	2.6	7.9
3. Services	**7.8 (51.4)**	**8.9 (56.7)**	**8.6 (57.6)**	**9.1**	**7.7**	**8.8**	**8.8**	**9.6**
3.1 Trade, Hotels, Restaurants, Transport, Storage and Communication	8.8	11.8	11.4	11.5	12.3	10.8	11.1	12.4
3.2 Financing, Insurance, Real Estate and Business Services	8.0	7.1	7.1	7.0	5.5	8.2	7.7	8.3
3.3 Community, Social and Personal Services	6.9	5.8	5.9	8.2	3.0	5.6	7.2	6.1
3.4 Construction	5.7	7.0	5.2	5.0	4.6	7.2	4.1	7.9
4. Real GDP at Factor Cost	**6.0 (100)**	**8.5 (100)**	**6.9 (100)**	**7.6**	**6.7**	**6.4**	**7.0**	**8.1**

*: Quick Estimates. #: Revised Estimates. N.A: Not Available.
Note : Figures in parentheses denote shares in real GDP.
Source : Central Statistical Organisation.

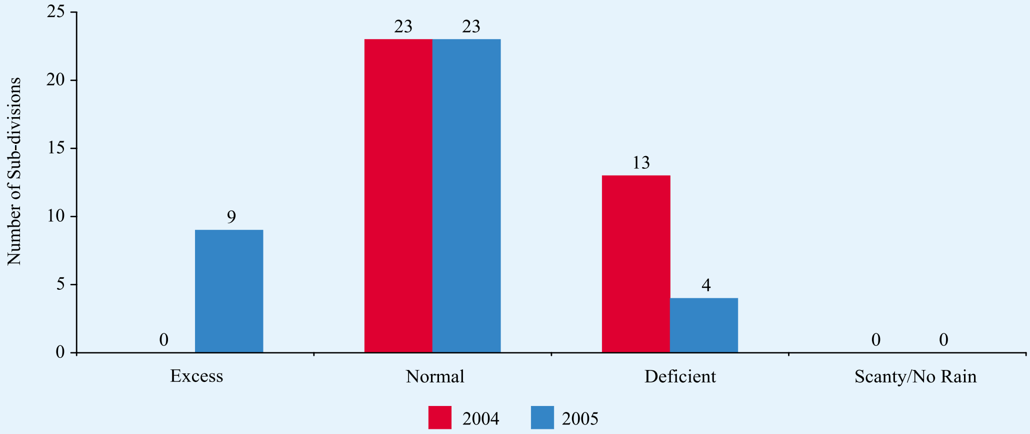
Agricultural Situation

According to the India Meteorological Department (IMD) forecast on July 6, 2005, the rainfall during the South-West monsoon season (June-September) 2005, for the country as a whole, was likely to be 98 per cent of the Long Period Average (LPA) with a model error of +/- 5 per cent. The progress of the monsoon was weak till June 22, 2005, with cumulative rainfall being 49 per cent below normal. In the subsequent period, monsoon picked up, offsetting the earlier shortfall. The cumulative rainfall recorded during the season (June 1 to September 30, 2005) was, thus, only one per cent below normal as compared with 13 per cent below normal during the corresponding period of the previous year. Of the 36 meteorological sub-divisions, cumulative rainfall was excess/normal in 32 sub-divisions (23 sub-divisions during last year) and deficient in 4 sub-divisions (13 sub-divisions during last year) (Chart 1). At the district level, 65 percent of the total number of districts received excess/normal rainfall, while the rest received deficient rain. Concomitantly, the total live water storage as on October 14, 2005 in the 76 major reservoirs[1] monitored by the Central Water Commission improved significantly to 81 per cent of the Full Reservoir Level (FRL) as compared with 65 per cent a year ago.

Kharif sowing which had been initially adversely affected due to delayed and weak monsoon picked up with the revival of the monsoon. Accordingly, as on October 10, 2005, the area coverage in the case of all major crops except for coarse cereals and oilseeds was higher than that in the previous year. However, area coverage under oilseeds was higher compared to its normal sown area (Table 2).

According to the First Advance Estimates released by the Ministry of Agriculture on September 16, 2005, total *kharif* foodgrains production during

Chart 1: South-West Monsoon: Cumulative Rainfall
(June 1 to September 30)



[1] These reservoirs account for 63 per cent of the total reservoir capacity of the country.

Table 2: Progress of Area under *Kharif* Crops - 2005-06

(Million hectares)

Crop	Normal Area	Area Coverage (As on October 10)		
		2004	2005	Variation
1	2	3	4	5
Rice	39.9	34.7	36.1	1.4
Coarse Cereals	22.9	22.5	21.8	-0.7
Of which :				
Bajra	9.3	9.0	8.2	-0.8
Jowar	4.6	3.9	3.8	-0.1
Maize	6.0	7.1	7.3	0.2
Pulses	10.6	11.0	11.2	0.2
Cotton	8.3	8.5	8.5	0.0
Kharif Oilseeds	15.1	17.8	17.3	-0.5
Of which :				
Groundnut	5.5	5.7	5.6	-0.1
Soyabean	6.3	8.0	7.7	-0.3
Sesamum	1.6	1.9	1.8	-0.1
Niger	0.5	0.4	0.3	-0.1
Sugarcane	4.3	3.8	4.1	0.3
All Crops	101.0	99.0	99.9	0.9

Source: Ministry of Agriculture, Government of India.

2005-06 at 105.3 million tonnes will be marginally higher (1.9 per cent) than last year but notably lower than that achieved in 2003-04 (Tables 3 and 4). The increase in the foodgrains production is expected to emanate mainly from higher output of rice and maize. Among the commercial crops, the output of oilseeds and cotton is estimated to decline while that of sugarcane is expected to show a significant improvement.

Table 3: *Kharif* Production: 2005-06

(Million tonnes)

Crops	2004-05*	2005-06**	Variation (Per cent)
1	2	3	4
Total Foodgrains	**103.3**	**105.3**	**1.9**
Rice	71.7	73.8	2.9
Coarse Cereals	26.7	26.4	-1.1
Of which :			
Jowar	4.0	3.9	-2.5
Bajra	8.1	7.8	-3.7
Maize	11.6	12.2	5.2
Pulses	5.0	5.0	0.0
Other Kharif Pulses	2.4	2.7	12.5
Tur	2.6	2.3	-11.5
Oilseeds	14.9	14.6	-2.0
Of which :			
Groundnut	5.3	5.9	11.3
Soyabean	7.5	6.6	-12.0
Cotton#	17.0	15.9	-6.5
Jute@	9.6	9.2	-4.2
Mesta@	0.9	0.9	0.0
Sugarcane	232.3	257.7	10.9

: Million bales of 170 kgs. each. @: Million bales of 180 kgs. each.
* : 4th Advance Estimates. **:1st Advance Estimates.
Note : The figures given for individual crops will not add up to coarse cereals, total foodgrains and total oilseeds as some individual crops are not covered in the table.
Source: Ministry of Agriculture, Government of India.

Table 4: Agricultural Production

(Million tonnes)

Crop	2003-04		2004-05	
	T	A	T	A $
1	2	3	5	6
Rice	93.0	88.3	93.5	85.3
Wheat	78.0	72.1	79.5	72.0
Coarse Cereals	34.0	38.1	36.8	33.9
Pulses	15.0	14.9	15.3	13.4
Total Foodgrains	**220.0**	**213.5**	**225.1**	**204.6**
Kharif	111.7	116.9	113.8	103.3
Rabi	108.3	96.6	111.3	101.3
Total Oilseeds	24.7	25.3	26.2	26.1
Kharif	14.7	16.8	16.3	14.9
Rabi	10.0	8.5	9.9	11.2
Sugarcane	320.0	237.3	270.0	232.3
Cotton #	15.0	13.9	15.0	17.0
Jute and Mesta ##	12.0	11.2	11.8	10.5

T : Target. A : Achievement. $: Fourth Advance Estimates.
: Million bales of 170 kgs each. ##: Million bales of 180 kgs each.
Source: Ministry of Agriculture, Government of India.

Food Management

The total procurement of rice and wheat during 2005-06 (up to September 29, 2005) at 19.6 million tonnes was 8.0 per cent lower than that in the corresponding period of the previous year. The total off-take of foodgrains during 2005-06 (April 1 to August 31, 2005) at 15.9 million tonnes was also lower by 3.2 per cent over the corresponding period of the preceding year, mainly due to a sharp fall in the off-take under the Open Market Sales (OMS) including exports and the Targeted Public Distribution System (TPDS) (Table 5). Reflecting the lower procurement, the total stocks of foodgrains with the Food Corporation of India (FCI) and the State agencies stood at around 19.2 million tonnes as on September 1, 2005, about 16.5 per cent lower than a year ago.

Industrial Performance

Industrial activity gathered further strength during the first five months of 2005-06, although there was some loss of momentum during July-August 2005. During April-August 2005, industrial production accelerated to 8.8 per cent led by the manufacturing sector (Chart 2). Electricity and mining sectors, on the other hand, recorded a deceleration. Slowdown in the mining sector may be attributable in part to the decline in production of crude oil caused by break-out of fire in the Mumbai-High oil field. Lower growth in electricity sector is attributable to shortages of coal and gas.

According to the use-based classification, basic goods recorded moderate pick-up benefiting from strong growth of cement and basic metal and alloy industries. Capital goods growth remained robust on the back of strong investment demand in the economy. The marginal deceleration during April-August 2005 could be attributed to high-base effect as also slow down in growth of machinery and equipment. Consumer goods recorded an impressive double-digit growth led largely

Table 5: Management of Food Stocks

(Million tonnes)

Month	Opening Stock of Foodgrains			Procurement of Foodgrains			Foodgrains Offtake				Closing Stock	Norms
	Rice	Wheat	Total	Rice	Wheat	Total	PDS	OWS	OMS - Domestic	Exports		
1	2	3	4	5	6	7	8	9	10	11	12	13
2004												
April	13.1	6.9	20.7	1.2	14.5	15.7	2.0	0.5	0.0	0.3	32.4	15.8
May	12.7	19.0	32.4	1.3	1.7	3.0	2.3	0.6	0.0	0.1	32.3	
June	12.3	19.4	32.3	0.9	0.5	1.4	2.3	1.0	0.0	0.1	30.6	
July	10.8	19.2	30.6	0.4	0.1	0.5	2.4	1.0	0.0	0.1	27.2	24.3
August	9.1	17.4	27.2	0.5	0.0	0.5	2.4	1.0	0.0	0.1	23.0	
September	7.1	15.8	23.0	0.2	0.0	0.2	2.5	1.0	0.0	0.1	20.3	
October	6.1	14.2	20.3	6.2	0.0	6.2	2.4	0.8	0.0	0.0	23.7	18.1
November	11.0	12.6	23.7	2.7	0.0	2.7	2.4	0.6	0.0	0.0	21.8	
December	11.1	10.7	21.8	2.6	0.0	2.6	2.6	0.7	0.0	0.0	21.7	
2005												
January	12.8	8.9	21.7	3.9	0.0	3.9	2.7	0.8	0.0	0.0	21.6	16.8
February	14.2	7.3	21.6	2.3	0.0	2.3	2.7	0.9	0.0	0.0	20.0	
March	13.7	5.8	20.0	1.7	0.0	1.7	2.7	1.7	0.0	0.0	18.0	
April	13.3	4.1	18.0	1.2	12.8	14.0	2.2	0.8	0.0	0.0	28.5	16.2
May	13.0	15.1	28.5	1.2	2.0	3.1	2.2	0.8	0.0	0.0	27.9	
June	11.6	15.7	27.9	0.8	0.1	0.9	2.2	1.5	.0.0	0.0	25.1	
July	10.1	14.5	25.1	0.4	0.0	0.4	2.3	0.8	0.1	0.0	21.4	26.9
August	8.0	13.0	21.4	0.9	0.0	0.9	2.1	0.8	0.1	0.0	19.2	
September	7.2	11.6	19.2	0.4	0.0	0.4	N.A	N.A	N.A	N.A	N.A	

PDS : Public Distribution System. OWS : Other Welfare Schemes. OMS : Open Market Sales.
N.A. : Not Available.
Note: Closing stock figures may differ from those arrived at by adding the opening stocks and procurement and deducting offtake, as stocks include coarse grains.
Source: Ministry of Consumer Affairs, Food and Public Distribution, Government of India.

by non-durable segment and its relative contribution to the overall IIP during April-August 2005 consequently went up significantly to 52.0 per cent. Consumer non-durables segment accelerated sharply during the period largely due to a turnaround

Chart 2: Year-on-Year Growth in Index of Industrial Production

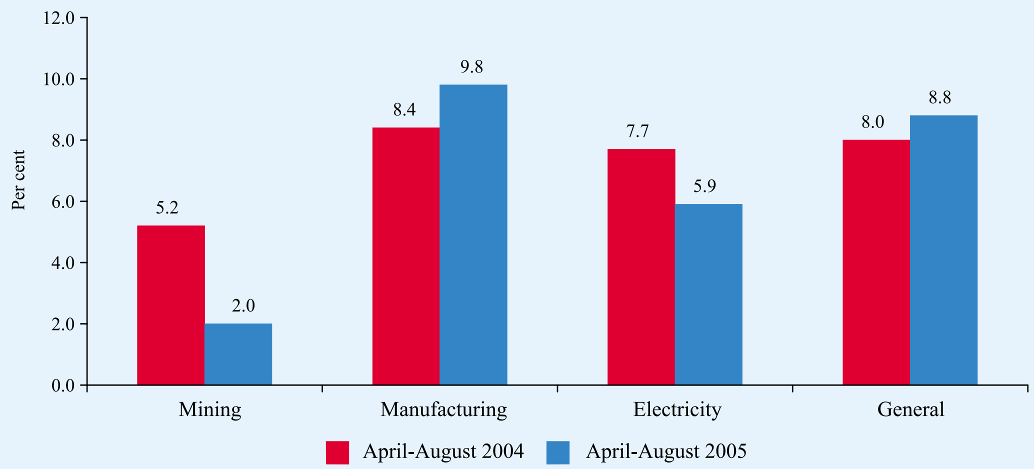
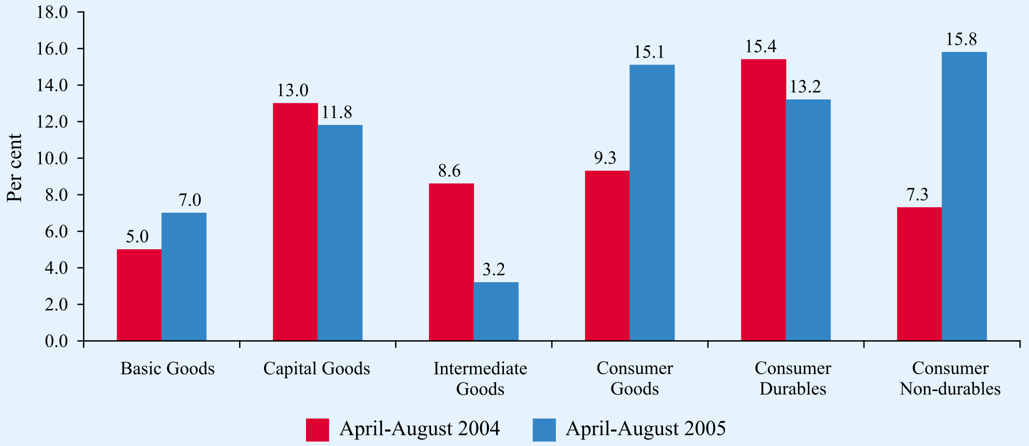


Chart 3: Year-on-Year Growth in IIP- Use Based Classification



in growth of food products and a marked acceleration in growth of beverages, tobacco and related products. Intermediate goods sector, however, witnessed a subdued performance mainly on account of slack in basic chemicals and chemical products and negative growth in petroleum products (Chart 3).

At the two-digit manufacturing level, 14 out of 17 industry groups recorded a positive growth during April-August 2005. Ten industry groups recorded an accelerated growth as compared with eight industry groups in the corresponding period of the previous year. Textile products (including wearing apparel) recorded the highest growth of 21.5 per cent during April-August 2005 benefiting from the complete phase out of textile quotas effective January 2005 (Table 6).

Table 6: Growth Performance of Manufacturing Industry Groups: April-August 2005

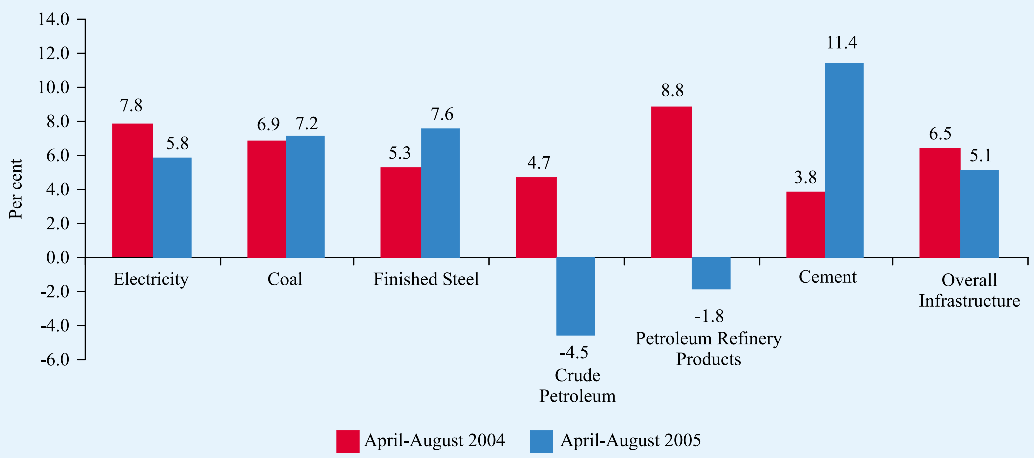
Acceleration in Growth	Deceleration in Growth	Negative Growth
1. Textiles products (including apparels) (21.5)	1. Chemicals and chemical products (12.7)	1. Wood and wood products, furniture and fixtures (-1.5)
2. Beverages, tobacco and related products (16.8)	2. Machinery and equipment other than transport equipment (8.8)	2. Wool, silk and man-made fibre textiles (-1.8)
3. Basic metal and alloy industries (16.8)	3. Leather and leather and fur products (4.8)	3. Metal products and parts (except machinery and equipment) (-3.5)
4. Other manufacturing industries (16.3)	4. Rubber, plastic, petroleum and coal products (3.6)	
5. Transport equipment and parts (11.0)		
6. Cotton textiles (10.4)		
7. Paper and paper products (7.6)		
8. Non-metallic mineral products (7.5)		
9. Food products (5.1)		
10. Jute and other vegetable fibre textiles (2.7)		

Note: Figures in parentheses are growth rates during April-August, 2005.

Infrastructure

During April-August 2005, the infrastructure sector continued to remain subdued on account of a decline in crude petroleum and petroleum refinery products and lower growth in electricity production (Chart 4). On the other hand, cement, finished steel and coal sectors recorded acceleration. Crude oil recorded negative growth on account of lower production due to disruption in production activity owing to break-out of fire in Mumbai High oilfield on July 27, 2005. High growth in the cement sector reflected robust demand from the construction sector as also the low base. Finished steel growth was buoyed up by domestic demand from the consumer durables, engineering and infrastructure sectors as well as global demand.

Chart 4: Year-on-Year Performance of Infrastructure Sector



Business Expectations Surveys

Business expectation surveys suggest that industrial activity is likely to remain buoyant. The National Council for Applied Economic Research (NCAER) business confidence index (BCI) rose for the fourth successive quarter and is now at its highest level in the last ten years since December 1995 (Table 7). FICCI's business

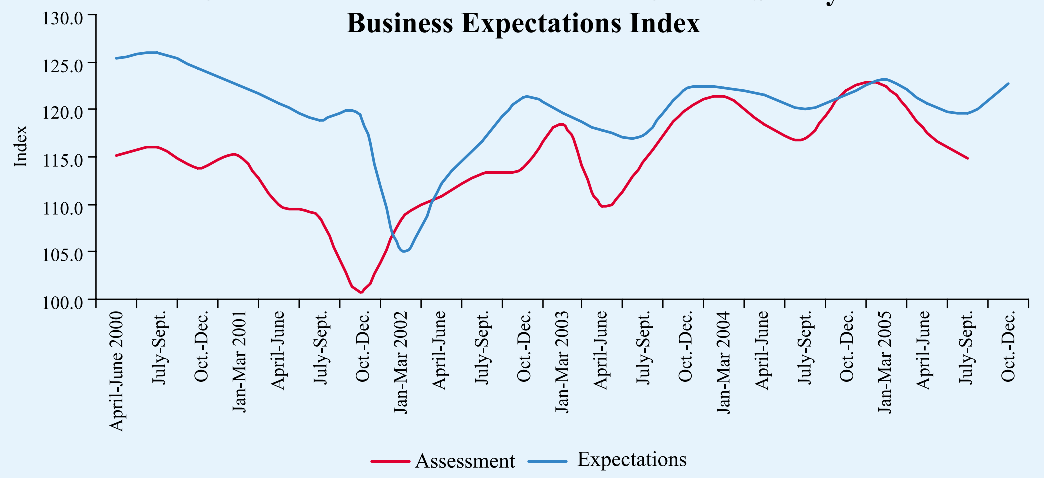
Table 7: Business Expectations Surveys

Agency	Business Expectations: Expectation for	Business Expectations: Index	Growth over previous round (Per cent)
1	2	3	4
Dun & Bradstreet	2005 (July-September)	Business Optimism Index	5.6
NCAER	2005 (July-December)	Business Confidence Index	0.7
FICCI	2005-06 (July-December)	Business Confidence Index	2.7
CII	2005-06 (April-September)	Business Confidence Index	1.4
RBI	2005-06 (October-December)	Business Expectations Index	2.6

confidence index also exhibited an improvement and revealed that the corporate houses are exuberant about their medium to long-term business outlook. According to the survey, 76 per cent of the respondents expected sales to be much higher over the next six months, 48 per cent expected 'higher to much higher' profits and 46 per cent are planning 'higher to much higher' investments. CII-ASCON survey for April-June 2005-06 also suggests the continuance of buoyant manufacturing industrial performance.

According to the Reserve Bank's latest Industrial Outlook Survey, the Business Expectations Index for October-December 2005 quarter increased by 2.6 per cent over the previous quarter's level (Chart 5). The assessment about the overall business situation for July-September 2005 showed the same level of confidence as in the previous quarter. The level of confidence was, however, higher than that during the corresponding quarter a year ago.

Chart 5: Reserve Bank's Industrial Outlook Survey: Business Expectations Index



Survey results indicate that the overall business situation, financial situation, availability of finance, production, order books, capacity utilisation, employment, exports and profit margins are expected to improve during the quarter October-December 2005 *vis-à-vis* July-September 2005 (Table 8).

These relatively optimistic expectations are corroborated by the improvements that have taken place in corporate financial performance in recent years. As a result of stronger capitalisation and operating cash flows, overall gearing measures have improved in the Indian corporate sector. With over 97 per cent of CRISIL ratings carrying 'stable' outlooks, and no rating carrying a 'negative' outlook, the current financial health of corporate India can be adjudged to be healthy. However, there are some indications that the corporate sector will

Table 8: Net Response on 'A Quarter Ahead' Expectations about Industrial Performance

(Per cent)

	Parameter	Response	Oct.-Dec. 2004 (955)	Jan.-March 2005 (987)	Apr-June 2005 (987)	July-Sept. 2005 (816)	Oct-Dec. 2005 (961)
	1	2	3	4	5	6	7
1.	Overall business situation	Better	47.4	47.4	44.3	45.5	51.3
2.	Financial situation	Better	37.0	37.5	36.7	36.7	42.3
3.	Working capital finance requirement	Increase	30.9	29.2	27.2	28.8	32.7
4.	Availability of finance	Improve	28.6	31.3	30.8	30.7	34.1
5.	Production	Increase	44.5	45.9	38.7	40.7	46.9
6.	Order books	Increase	42.6	42.2	37.4	39.6	43.7
7.	Cost of raw material	Decrease	-39.0	-41.8	-36.7	-43.6	-30.0
8.	Inventory of raw material	Below average	-4.1	-7.4	-4.3	-4.2	-6.9
9.	Inventory of finished goods	Below average	-3.5	-5.2	-3.1	-4.2	-3.3
10.	Capacity utilisation	Increase	27.8	31.3	27.7	25.4	31.1
11.	Level of capacity utilisation	Above normal	6.3	12.9	8.1	7.6	10.9
12.	Assessment of the production capacity	More than adequate	5.4	6.6	5.7	5.3	5.0
13.	Employment in the company	Increase	6.0	8.0	7.7	7.8	12.7
14.	Exports, if applicable	Increase	31.6	31.5	30.2	32.5	33.3
15.	Imports, if any	Increase	21.3	22.2	20.3	23.7	19.2
16.	Selling prices are expected to	Increase	7.6	8.6	11.0	13.3	7.8
17.	If increase expected in selling prices	Increase at lower rate	9.9	8.2	13.5	14.0	16.6
18.	Profit margin	Increase	4.4	5.6	6.3	7.1	9.6

Note: 1. Figures in parentheses represent number of companies covered in the Survey.
2. 'Net response' is measured as the per cent share differential between the companies reporting 'optimistic' (positive) and 'pessimistic' (negative) responses; responses indicating *status quo* (no change) are not reckoned. Higher 'net response' indicates higher level of confidence and *vice versa*.

have to be watchful in the short to medium term future with the possible unfolding of potential risks. These risks could emanate from the sharp increases in oil prices, plateauing of growth rates in some key industries and infrastructure constraints. Furthermore, with the manufacturing sector operating at high capacity utilisation levels, significant growth over the medium to long term will call for fresh investments that could also involve higher borrowing, and consequent exposure to associated risks and possible deterioration of gearing ratios. Illustratively, a recent analysis of trends in its ratings by CRISIL shows that the modified credit ratio (the ratio of upgrades plus reaffirmations to downgrades plus reaffirmations) dropped after three years of increase - it fell to 1.05 during April-September 2005 from the all time high of 1.16 in 2004-05. With the ratio remaining above 1.0 indicating continuing credit health of the corporate sector, this change points to the stiffer challenges that could be in store for corporate India in maintaining or improving its credit quality in the short to medium term.

Table 9: Indicators of Service Sector Activity

(Growth rates in per cent)

Sub-sector	April-August 2004	April-August 2005
1	2	3
Tourist arrivals	26.4	26.0
Commercial vehicles production	41.4	11.6
Railway revenue earning freight traffic	6.3	10.9
New cell phone connections	31.9	34.3
Cargo handled at major ports	10.3	13.6
Civil aviation		
a) Export cargo handled (April-July)	7.5	9.1
b) Import cargo handled (April-July)	36.8	7.8
c) Passengers handled at international terminals (April-July)	18.5	12.5
d) Passengers handled at domestic terminals (April-July)	26.8	20.4
Roads: Upgradation of Highways (April-July)	-3.1	-0.7
Cement	3.8	11.4
Steel	5.3	7.6
Aggregate deposits (April-September)	6.8	12.3
Non-food credit (April-September)	11.9	14.8
Central Government expenditure	32.1	33.2

Services Sector

Services sector growth during the first quarter of 2005-06 accelerated to 9.6 per cent from 9.1 per cent a year ago, led by all its major constituent sectors (see Table 1). The growth of the 'trade, hotels, restaurants, transport, storage and communication' sub-sector, apart from reflecting the upbeat economic climate in the country, benefited from strong tourist arrivals, higher traffic handled by the railways, increased cargo handled at major ports, growth in cargo and passengers handled by civil aviation, and the continued surge in cell phone connections. Financing, real estate and business services were propelled by the Information Technology (IT) and IT Enabled Services and Business Process Outsourcing, and upsurge in bank credit. Construction sector recorded a higher growth in consonance with the uptrend in cement production. Latest available information on the major indicators of services sector indicates continued buoyancy in the second quarter of 2005-06 (Table 9).

The revival of the South-West monsoon, the acceleration of the industry, buoyancy in services and positive business confidence and expectations have improved growth prospects for 2005-06. The forecasts by different agencies and institutions for the overall growth during 2005-06 are set out in Table 10.

Table 10: Projections of Real Gross Domestic Product for India by Various Agencies for 2005-06

Agency	Projections (Per cent)	Assumptions (Sectoral)	Month of Projections
1	2	3	4
ADB	6.9	Normal monsoon. Agriculture 4.4 per cent Industry 6.7 per cent Services 7.7 per cent	September, 2005
BIS	7.1		June, 2005
CII	a) 7.2	Agriculture 3.0 per cent Industry 8.1 per cent Services 8.3 per cent	end-May, 2005
	b) 7.3	Agriculture 3.2 per cent	October, 2005
CMIE	a) 6.0	Agriculture (-) 0.7 per cent Industry 8.5 per cent Services 7.5 per cent	June 2005
	b) 6.8	Agriculture 3.0 per cent Industry 8.5 per cent Services 7.5 per cent	August, 2005
CRISIL	a) 7.0	Agriculture 3.0 per cent Industry 7.0 per cent Services 8.6 per cent	May, 2005
	b) 7.0	Agriculture 2.5 per cent Industry 7.4 per cent Services 8.5 per cent	September, 2005
NCAER	a) 7.2		Mid-May, 2005
	b) 7.05-7.1	Agriculture 2.5 per cent Industry 7.54 per cent Services 8.55 per cent	July, 2005
IMF	a) 6.7 b) 7.1		April, 2005 September, 2005
Ministry of Finance	7.0	Normal monsoon Agriculture 3.0 per cent Industry and Services expected to perform well	May, 2005
Reserve Bank of India	Around 7.0	Normal monsoon Agriculture 3.0 per cent Industry and Services expected to maintain current growth momentum.	April, 2005

II. FISCAL SITUATION

Combined Government Finances: 2005-06

Key fiscal indicators of combined finances are budgeted to decline in 2005-06, primarily through higher revenue mobilisation especially direct taxes and supported by expenditure management with an emphasis on outcomes than mere outlays (Table 11). Fiscal policy for 2005-06 seeks to continue with the process of fiscal consolidation while aiming to build the spirit of cooperative fiscal federalism by enhanced transfer of resources to States.

Table 11: Key Fiscal Indicators

(Per cent to GDP)

Year	Primary Deficit	Revenue Deficit	Gross Fiscal Deficit
1	2	3	4
		Centre	
2002-03	1.1	4.4	5.9
2003-04	-0.03	3.6	4.5
2004-05 RE	0.4	2.7	4.5
	(0.05)	(2.6)	(4.1)
2005-06 BE	0.5	2.7	4.3
		States	
2002-03	1.3	2.2	4.1
2003-04	1.5	2.2	4.4
2004-05 RE	1.0	1.4	3.8
2005-06 BE	0.4	0.7	3.1
		Combined	
2002-03	3.1	6.6	9.5
2003-04	2.0	5.8	8.4
2004-05 RE	2.2	4.1	8.3
2005-06 BE	1.7	3.4	7.7

RE : Revised Estimates. BE : Budget Estimates.

Note : 1. Figures in parentheses are provisional accounts for 2004-05.
2. Data in respect of States are provisional from 2003-04 onwards.

Centre's Fiscal Situation

Available information for the first five months of 2005-06 (April-August) indicates improvement in Central Government finances, benefiting from higher tax collections and expenditure management through control over non plan expenditure. The improvement in Central Government finances was also reflected in its surplus cash balances with the Reserve Bank, which during April-September 2005 were almost four times that of a year ago.

During April-August 2005, tax collections increased mainly due to direct taxes and customs duties. Consequently, there was an improvement in revenue receipts as a ratio of the budget estimates (BE) during April-August 2005 (Table 12). Non-tax revenue, as a proportion to BE, was, however, lower than in the first five months of the preceding fiscal year. Revenue expenditure, relative to the BE, was higher during the period under review mainly on account of higher grants to States and expenditure on social services. Nevertheless, the revenue deficit, as a proportion to

Table 12: Central Government Finances during April-August 2005

(Rupees crore)

Items	2005-06 (Budget Estimates)	April-August 2004	April-August 2005	Per cent of Budget Estimates April-August 2004	Per cent of Budget Estimates April-August 2005
1	2	3	4	5	6
1. Revenue Receipts (i + ii)	3,51,200	68,357	81,169	22.1	23.1
i) Tax Revenue	2,73,466	45,721	58,482	19.5	21.4
ii) Non-tax Revenue	77,734	22,636	22,687	30.0	29.2
2. Non-debt Capital Receipts	12,000	32,752	3,292	105.3	27.4
3. Non-Plan Expenditure	3,70,847	1,15,818	1,23,453	34.9	33.3
of which:					
i) Interest Payments	1,33,945	45,091	44,770	34.8	33.4
ii) Defence	83,000	21,767	19,249	28.3	23.2
iii) Subsidies	46,358	18,422	19,947	43.6	43.0
4. Plan Expenditure	1,43,497	37,800	47,336	26.0	33.0
5. Revenue Expenditure	4,46,512	1,31,263	1,55,541	34.1	34.8
6. Capital Expenditure	67,832	22,355	15,248	24.2	22.5
7. Total Expenditure	5,14,344	1,53,618	1,70,789	32.1	33.2
8. Revenue Deficit	95,312 (2.7)	62,906	74,372	82.6	78.0
9. Gross Fiscal Deficit	1,51,144 (4.3)	52,509	86,328	38.2	57.1
10. Gross Primary Deficit	17,199 (0.5)	7,418	41,558	93.8	241.6

Note: Figures in parentheses are per cent to GDP.

BE, was lower than the position a year ago although the primary deficit was higher. Aggregate expenditure increased during April-August 2005, reflecting higher revenue expenditure. The fiscal deficit was higher as a proportion to BE mainly on account of lower recovery of loans from the States reflecting the discontinuation of the debt swap scheme (DSS). Recoveries of loans on account of the DSS for the States had enabled a substantial increase in non-debt receipts of the Centre during the previous year. The fiscal deficit, as a proportion to BE, during April-August 2005 was lower than its level (adjusted for DSS receipts) a year ago.

Financing of the Union Budget

Net market borrowings [excluding allocations under the Market Stabilisation Scheme (MSS)] for 2005-06 - budgeted at Rs.1,03,791 crore - would finance 68.7 per cent of the GFD in 2005-06 as compared with 33.0 per cent in the previous year. Including repayment obligations of Rs.61,676 crore, gross market borrowings of the Central Government work out to Rs.1,65,467 crore. Draw down of surplus cash balances with the Reserve Bank would finance 2.1 per cent of the GFD as against 15.1 per cent in 2004-05 (RE). Securities against small savings, which financed 24.4 per cent of the GFD in 2004-05, are expected to finance only 2.0 per cent. As securities against small savings largely represented the transactions under the DSS for which there is no provision in the Budget for 2005-06, the market borrowings would finance the larger part of the GFD.

During 2005-06 (up to October 20, 2005), the actual issuances of dated securities amounted to Rs.84,000 crore as compared with Rs.96,000 crore scheduled in the

Table 13: Central Government Securities Issued during 2005-06

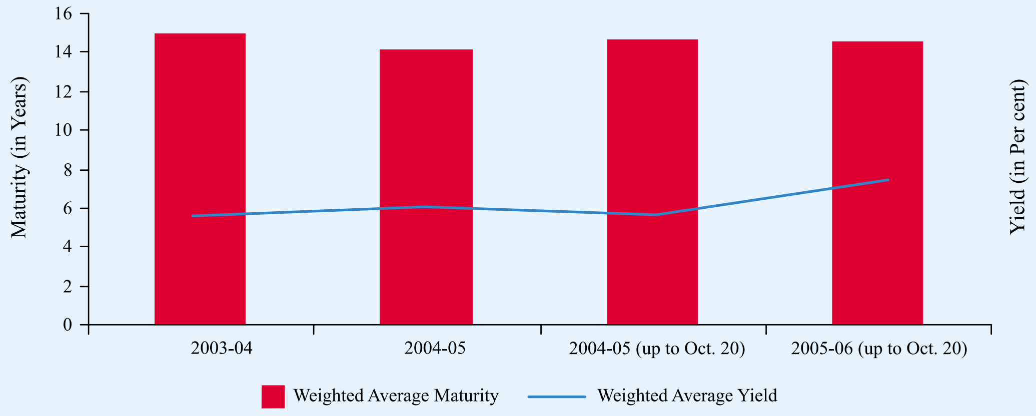
Date of Auction	Notified Amount (Rs. crore)	Residual Maturity (Years)	Cut-off Yield (Per cent)
1	2	3	4
April 5, 2005	5,000	6.98	6.80
April 5, 2005	3,000	27.39	7.79
April 19, 2005	5,000	11.74	7.48
April 19, 2005	2,000	29.31	7.94
May 3, 2005	6,000	5.03	6.99
May 3, 2005	2,000	29.27	7.98
May 24, 2005	4,000	16.05	7.28
June 6, 2005	4,000	15.98	7.47
June 6, 2005	6,000	8.86	6.91
June 23, 2005	5,000	10.81	6.91
July 5, 2005	6,000	8.16	7.06
July 5, 2005	4,000	15.90	7.57
July 18, 2005	5,000	15.86	7.81
August 11, 2005	3,000	28.99	7.44
August 11, 2005	5,000	11.43	7.14
August 18, 2005	5,000	8.66	7.04
August 18, 2005	3,000	28.98	7.55
September 8, 2005	5,000	13.04	7.23
September 8, 2005	3,000	30.00	7.40
October 6, 2005	3,000	29.92	7.66

calendar so far (Table 13). This was on account of a reduction in the notified amount from Rs.4,000 crore (as per the issuance auction calendar) to Rs.2,000 crore for maturity of 29.27 years in the auction of May 3, 2005 and rejection of bids for an issue of Rs. 6,000 crore on October 6, 2005. Furthermore, the auction of dated securities scheduled for October 18-25, 2005 for an amount of Rs. 4,000 crore was cancelled based on a review of the current borrowing requirements of the Government of India. Gross and net market borrowings raised by the Centre (up to October 20, 2005) amounted to 60.1 per cent and 50.0 per cent of the BE as compared with 49.8 per cent and 29.0 per cent, respectively, a year ago.

The weighted average yield of the dated securities issued increased to 7.29 per cent during 2005-06 (up to October 20, 2005) from 5.76 per cent during the corresponding period of 2004-05, reflecting the upturn in the interest rate cycle (Chart 6). The weighted average maturity of dated securities of the Central Government during the same period at 15.11 years was higher than 14.30 years in the corresponding period of the preceding year.

The Centre's Ways and Means Advances (WMA) limits from the Reserve Bank continued to be fixed at Rs.10,000 crore for the first half (April-September) of 2005-06 and Rs.6,000 crore for the second half (October-March). Reflecting its comfortable liquidity position, the Centre has availed WMA only on two occasions (May 3 and June 4, 2005) during 2005-06 so far. The comfortable liquidity position was also reflected in the Centre's surplus cash balances with the Reserve Bank which averaged Rs. 15,954 crore during April-September 2005, significantly higher than that of Rs.4,337 crore during the corresponding period of 2004-05 (Chart 7).

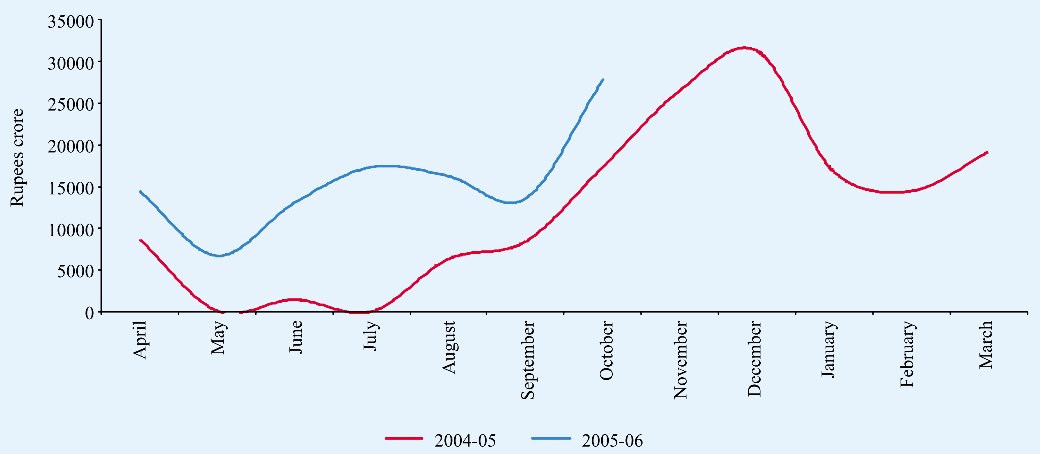
Chart 6: Weighted Average Yield and Maturity of Primary Auctions of the Dated Securities



Assessment of Quarterly Central Government Finances (April-June, 2005)

The Central Government released the "Statement on Quarterly Review of the Trends in Receipts and Expenditure in Relation to Budget" for the first quarter of 2005-06 on August 24, 2005 as required under the Fiscal Responsibility and Budget Management (FRBM) Act, 2003. The Quarterly Review Statement (QRS) found the performance of the Indian economy to be 'satisfactory' during the first quarter of the current year. During this period, the Central Government finances reflected increased tax buoyancy on account of tax reforms, improved collection of customs duties, moderation in the pace of expenditure, decline in food and petroleum subsidies and consequent moderation in the deficit levels. The Government,

Chart 7: Daily Average Cash Balances of the Central Government



however, expressed concern over lower collections under excise duties. The Government reiterated the need for a stricter financial discipline by keeping a vigil on unspent balances before release of fresh funds and assured that steps are being taken to improve the pace of actual utilisation through close monitoring.

The QRS's assessment of the progress in the implementation of the fiscal policy strategy articulated in the Union Budget 2005-06 reveals corrective measures in toning up the tax administration and rationalisation of expenditure management. In this context, the Government emphasised on shifting focus from mere "release of funds" (outlays) to "actual utilisation for intended purposes" (outcomes). The fiscal policy strategy has worked well so far as evident from the fiscal performance during the first quarter of 2005-06.

Outcome Budget

In order to measure the development outcomes of all major programmes/ schemes initiated after the announcement of the Union Budget, the Government, in consultation with the Planning Commission, released the 'Outcome Budget' for 2005-06 on August 25, 2005. In this document, the various Ministries/ Departments have set out targets of intermediate outputs/outcomes, pertaining to Plan Expenditure, in measurable terms. The outcome budget is basically a pre-expenditure instrument to realise the Government's vision through clearly defined outcomes, which will lend greater transparency to the budgetary process. From 2006-07, an outcome budget for non-Plan Expenditure is also scheduled and, over a period of time, it would replicate the budgetary process in terms of intended outcomes.

State Finances

Financing of the States' Budgets

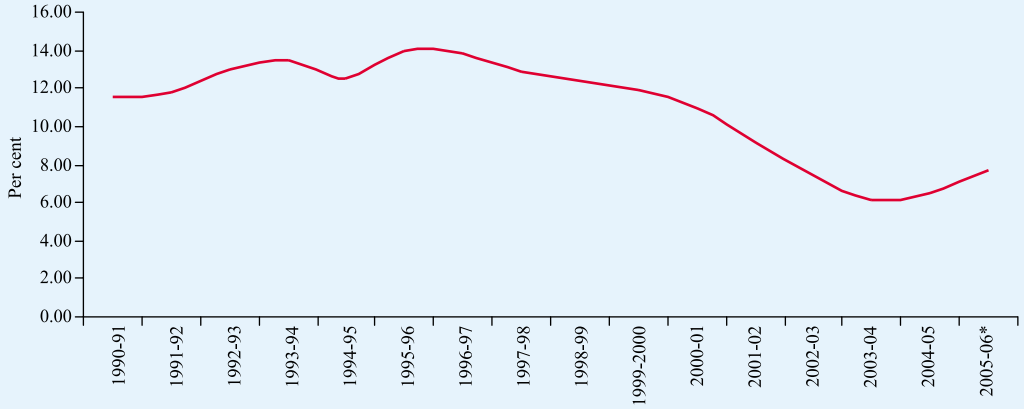
Net allocation under market borrowing programme for State Governments is provisionally placed at Rs.16,112 crore during 2005-06. Taking into account the repayments of Rs.6,274 crore and additional borrowing allocation of Rs.45 crore, the gross allocation amounts to Rs.22,431 crore. States have generally not taken into account the recommendations of the Twelfth Finance Commission (TFC). Reckoning the net Central loans for State Plans as reported in the Union Budget 2005-06 and assuming that the State Plans are maintained at the budgeted level, the market borrowings during 2005-06 would not be substantially higher than the provisional net allocation amount on account of higher devolution of taxes and grants as envisaged in the Union Budget in accordance with the TFC recommendations and larger receipts from NSSF. During 2005-06 so far (up to October 20, 2005), the States have raised an amount of Rs.14,265 crore, *i.e.*, 63.6 per cent of their gross allocation for 2005-06 (Table 14).

Table 14 : Market Borrowings of the State Governments during 2005-06

Item	Date	Cut-off Rate (Per cent)	Tenor (Years)	Amount Raised (Rs. crore)
1	2	3	4	5
A. Tap Issues				
i. First Tranche	May 17-18, 2005	7.77	10	7,554
ii. Second Tranche	September 13, 2005	7.53	10	2,931
Total (i to ii)				**10,485**
B. Auctions				
i. First	April 20, 2005	7.45	10	300
ii. Second	June 14, 2005	7.39	10	2,181
iii. Second	June 14, 2005	7.35	10	210
iv. Third	August 4, 2005	7.32	10	250
v. Fourth	September 27, 2005	7.45	10	367
vi. Fourth	September 27, 2005	7.42	10	146
vii. Fourth	September 27, 2005	7.50	10	327
Total (i to vii)				**3,781**
Total (A+B)				**14,265**

The weighted average interest rate of market loans during 2005-06 (up to October 20, 2005) firmed up to 7.62 per cent from 5.90 per cent in the comparable period of 2004-05 (Chart 8).

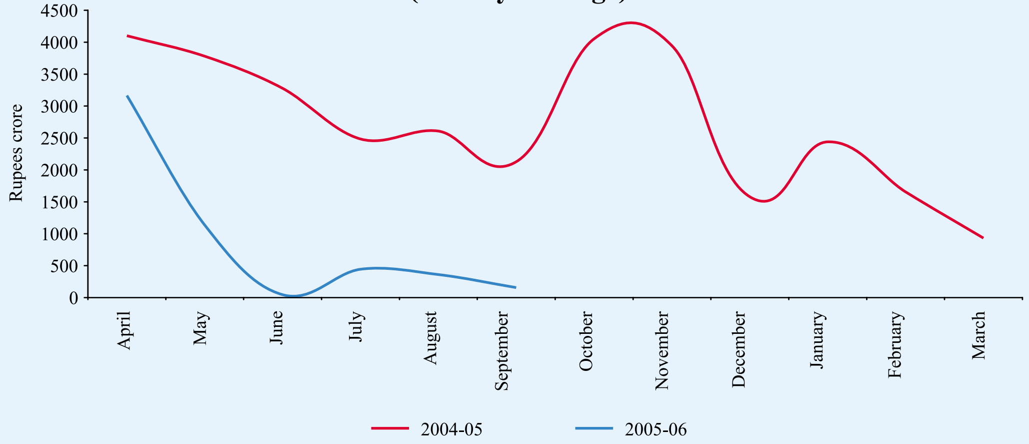
Chart 8: Weighted Average Interest Rate on State Governments' Market Borrowings



*: Up to October 20, 2005.

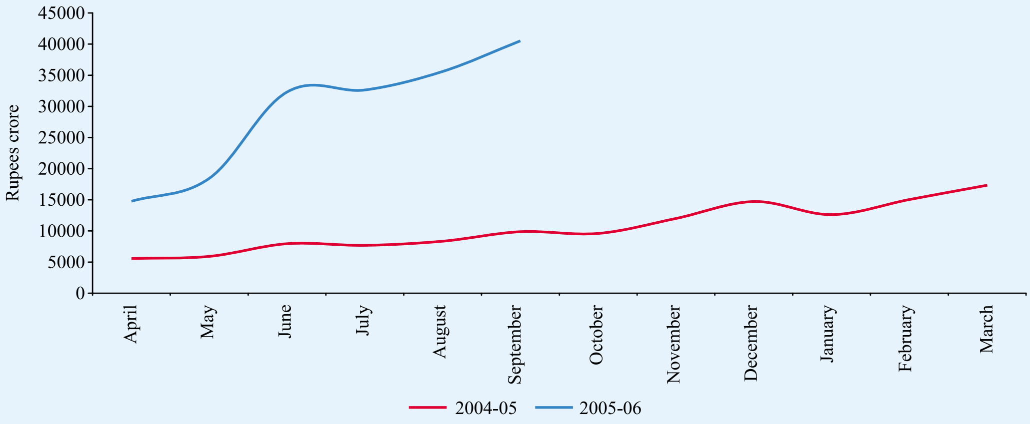
The weekly average utilisation of WMA and overdraft by the States during 2005-06 (up to end-September 2005) amounted to Rs.885 crore, significantly lower than that of Rs.3,064 crore in the corresponding period of the previous year (Chart 9). Nine States have resorted to overdraft during 2005-06 so far (up to September 30, 2005) as compared with 12 States during the corresponding period of the previous year.

Chart 9: Utilisation of WMA and Overdraft by the States (Weekly Average)



The improvement in the overall cash position of the States was also reflected in a spurt in their weekly average investments in 14-day Intermediate Treasury Bills to Rs.29,052 crore during 2005-06 (up to end-September 2005) from Rs.7,565 crore in the corresponding period of the previous year (Chart 10).

Chart 10: Investments in 14-day Intermediate Treasury Bills by the State Governments (Weekly Average)



Outlook

The major fiscal challenges in the near future are management of subsidies, financing of food for work and employment guarantee programmes and neutralising the impact of lower loan recoveries from States. The routing of external loans to States through the Consolidated Fund of India would marginally increase the Central Government's expenditure relative to the Budget Estimates, 2005-06. However, the buoyant macroeconomic environment is providing an impetus to the Government's efforts and the economy has so far demonstrated considerable resilience to high and volatile international crude prices. The effort to improve tax collections in the presence of all round buoyant growth will need to be intensified in these circumstances. The hike in international oil prices and the possibility that they may remain high longer than anticipated earlier will continue to pose significant risk to the fisc, directly or indirectly, unless appropriately passed on. Furthermore, the interest burden on the Oil Bonds to be issued to oil companies has to be borne by the Government, which will have some implications for the Government finances. Their redemption in future years adds to the liability of the Government.

III. MONETARY AND LIQUIDITY CONDITIONS

Monetary Survey

Monetary conditions have remained comfortable during 2005-06 so far despite a sustained pick-up in credit demand from the commercial sector. Banks were able to finance the higher demand for commercial credit by curtailing their incremental investments in Government securities. Strong growth in deposits in the current fiscal year and higher investments by non-bank sources in Government securities also enabled banks to meet credit demand. Concomitantly, reserve money expansion was high, reflecting a lower order of sterilisation operations by the Reserve Bank. Broad money (M_3) growth, on a year-on-year basis, was above the indicative trajectory of 14.5 per cent projected in the Annual Policy Statement (April 2005) (Chart 11). Expansion in the residency-based new monetary aggregate (NM_3) – which excludes foreign currency non-resident deposits – was higher than M_3 on account of net outflows under foreign currency deposits and continued access of banks to call/term borrowings (Table 15).

Currency demand fell in the second quarter in line with the trend in the previous year. Year-on-year growth in currency, which was lower than a year ago till mid-September 2005, however, edged up during the last fortnight of September (Chart 12).

Chart 11: Growth in Broad Money

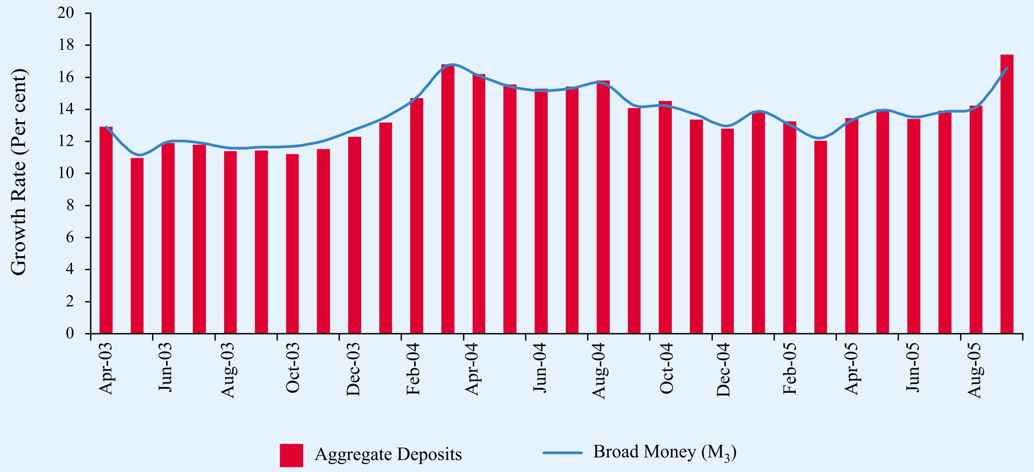


Table 15: Monetary Indicators

(Amount in Rupees crore)

Item	Outstanding as on September 30, 2005	Variation (year-on-year) 2004 Amount	2004 Per cent	2005 Amount	2005 Per cent
1	2	3	4	5	6
I. Reserve Money*	5,17,693	66,894	18.0	78,521	17.9
II. Broad Money (M_3)	24,65,763	2,69,186	14.6	3,51,296	16.6
a) Currency with the Public	3,63,925	36,746	12.9	42,534	13.2
b) Aggregate Deposits	20,96,624	2,29,581	14.8	3,10,587	17.4
i) Demand Deposits	3,32,074	35,577	15.8	70,821	27.1
ii) Time Deposits	17,64,550	1,94,004	14.6	2,39,767	15.7
of which: Non-Resident Foreign Currency Deposits	76,507	4,373	6.0	-214	-0.3
III. NM_3	24,28,068	2,80,460	15.7	3,58,217	17.3
of which: Call Term Funding from Financial Institutions	42,168	11,039	57.3	11,851	39.1
IV. a) L_1	25,23,954	2,97,864	16.1	3,74,434	17.4
of which: Postal Deposits	95,885	17,404	28.0	16,217	20.4
b) L_2	25,25,605	2,98,629	16.1	3,69,290	17.1
of which: FI Deposits	1,651	765	12.7	-5,144	-75.7
c) L_3	25,45,445	2,97,505	15.8	3,69,886	17.0
of which: NBFC Deposits	19,840	-1,124	-5.5	596	3.1
V. Major Sources of Broad Money					
a) Net Bank Credit to the Government (i+ii)	7,42,354	29,127	4.1	-4,648	-0.6
i) Net Reserve Bank Credit to Government	-33,950	-67,737		-42,644	
of which: to the Centre	-33,909	-64,453		-41,776	
ii) Other Banks' Credit to Government	7,76,304	96,863	15.1	37,996	5.1
b) Bank Credit to Commercial Sector	14,07,816	1,82,459	19.6	2,95,557	26.6
of which: Scheduled Commercial Banks' Non-food Credit	11,83,909	1,79,586	24.9	2,83,553	31.5
c) Net Foreign Exchange Assets of Banking Sector	6,60,700	1,47,770	34.2	81,075	14.0

* : As on October 14, 2005. FIs: Financial Institutions. NBFCs: Non-banking Financial Companies.

Note: 1. Data are provisional.

2. Select aggregates are adjusted for the effect of conversion of a non-banking entity into a banking entity effective October 11, 2004.

Growth in demand deposits remained high in tandem with the sustained pick-up in non-food credit and a buoyant primary capital market, with funds getting temporarily parked in demand deposits (Table 16).

Chart 12: Currency with the Public

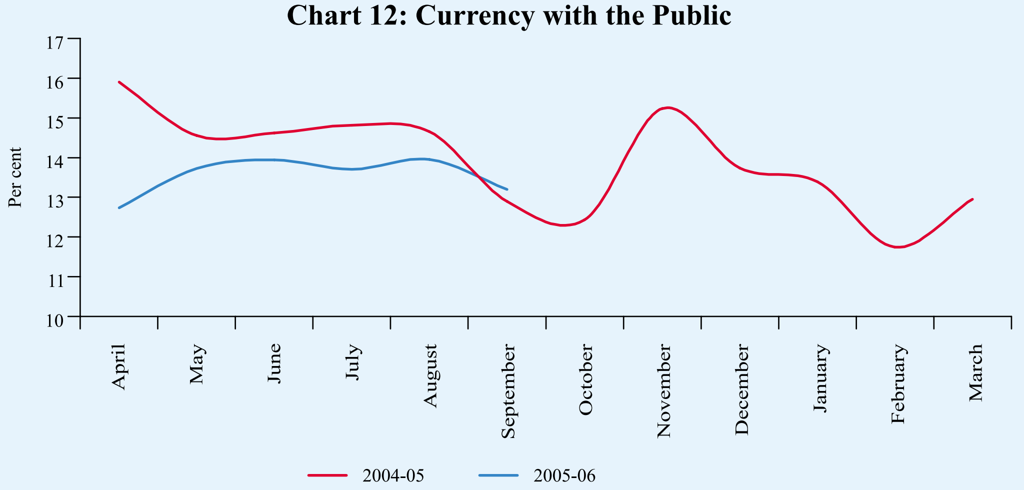


Table 16: Monetary Aggregates – Variations

(Rupees crore)

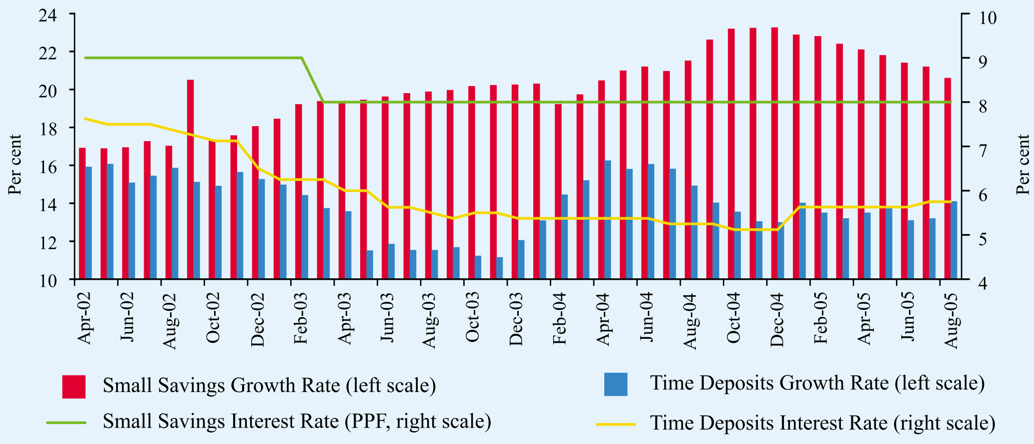
Item	2004-05	2004-05 Q1	Q2	Q3	Q4	2005-06 Q1	Q2
1	2	3	4	5	6	7	8
M_3 (=1+2+3 = 4+5+6+7-8)	2,48,262	69,831	16,999	53,459	1,07,974	1,05,850	1,09,544
Components							
1. Currency with the Public	40,797	14,540	-3,098	15,422	13,933	19,671	-11,514
2. Aggregate Deposits with Banks	2,06,106	56,754	19,342	37,725	92,284	87,737	1,20,764
2.1 Demand Deposits with Banks	25,391	-14,038	2,094	15,721	21,614	11,401	36,657
2.2 Time Deposits with Banks	1,80,716	70,792	17,248	22,004	70,671	76,337	84,107
3. 'Other' Deposits with RBI	1,359	-1,463	755	311	1,756	-1,558	294
Sources							
4. Net Bank Credit to Government Sector	15,002	12,986	-11,798	-4,524	18,338	6,980	-10,339
4.1 RBI's Net Bank Credit to Government Sector	-62,882	-34,143	-6,179	184	-22,744	9,275	-25,251
4.1.1 RBI's Net Credit to Central Government	-60,177	-30,029	-4,499	203	-25,852	14,600	-25,251
4.2 Other Bank Credit to Government Sector	77,884	47,129	-5,619	-4,708	41,082	-2,295	14,912
5. Bank Credit to Commercial Sector	2,64,389	38,057	40,093	1,07,789	78,451	64,221	95,737
6. Net Foreign Exchange Assets of Banking Sector	1,22,669	49,206	-1,335	32,891	41,907	-13,378	24,823
6.1 Net Foreign Exchange Assets of RBI	1,28,377	57,525	-5,260	31,462	44,651	-14,595	24,823
7. Governments' Net Currency Liabilities to the Public	152	37	9	89	17	47	26
8. Net Non-Monetary Liabilities of Banking Sector	1,53,949	30,454	9,969	82,787	30,739	-47,979	703
Memo:							
1. Non-resident Foreign Currency Deposits	802	953	-189	-654	692	-494	596
2. SCBs' Call-term Borrowing from Financial Institutions	44,853	5,409	530	35,464	3,451	643	7,178
3. Overseas Borrowing by Scheduled Commercial Banks	8,529	3,012	-658	6,267	-90	1,788	6,168

Note: Data include effect of conversion of a non-banking entity into a banking entity on October 11, 2005.

Year-on-year (y-o-y) growth in time deposits as on September 30, 2005 at 15.7 per cent was higher than a year ago, benefiting from modest increases in deposit rates and reflecting base effects of a low growth during the previous year. There was some deceleration in growth of small savings to 20.6 per cent by end-August 2005 from 23.3 per cent in December 2004. Nonetheless, the growth of small savings still remains substantially higher than that of time deposits reflecting both higher interest rates and tax incentives (Chart 13).

Food credit recorded a decline from its end-March 2005 level in line with a lower order of procurement of foodgrains. On the other hand, commercial sector's demand for bank credit continued to remain strong reflecting a strengthening of the industrial recovery and demand for housing credit. Accordingly, scheduled commercial banks' non-food credit, on a year-on-year basis, registered a growth of 31.5 per cent as on September 30, 2005 on top of a base as high as 24.9 per cent a year ago. Incremental credit-deposit ratio of SCBs remained above 100 per cent between November 2004 and August 2005 (Chart 14). Latest available data indicate that credit pick-up during April-August 2005 was quite broad-based. The high growth of credit to the priority sector reflected largely the sharp growth in agricultural credit as well as small housing loans (up to Rs.15 lakh). Amongst industries, credit to iron and steel, other metal and metal products, engineering, automobiles, cement, construction, paper, rubber, tobacco, textiles and gems and jewellery recorded an upsurge (see Table 35).

Chart 13: Time Deposits and Small Savings



In addition to bank credit, industry has also increasingly relied upon non-bank sources of funds in recent years. Equity issuances continued to be steady during April-September 2005, benefiting from buoyancy in capital markets. Mobilisation through issuances of commercial papers also remained strong. Funds raised through external commercial borrowings (ECBs), which were large during 2004-05, moderated. This was mainly on account of turnaround in short-term trade credits as oil companies increased their recourse to domestic financing (Table 17).

Sustained high growth in commercial credit was funded by the banks mainly by restricting their incremental investments in Government securities. Incremental investments by commercial and co-operative banks in the Government papers at Rs.12,617 crore in the current fiscal (up to September 30) were less than one-third of

Chart 14: Scheduled Commercial Banks' Credit Growth

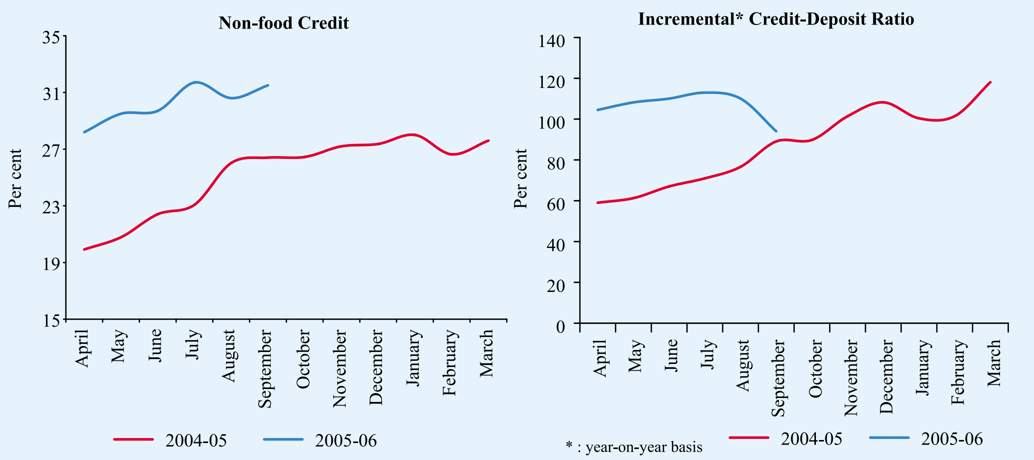


Table 17: Select Sources of Funds to Industry

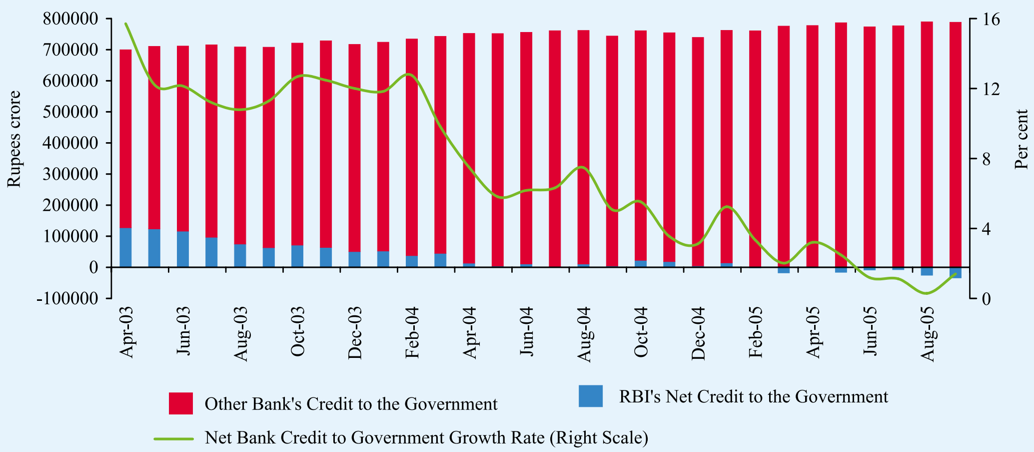
(Rupees crore)

Item	2004-05				2005-06	
	Q1	Q2	Q3	Q4	Q1	Q2
1	2	3	4	5	6	7
A. Bank Credit to Industry	6,636	11,186	13,733	21,680	11,148	14,698 @
B. Flow from Non-banks to Corporates						
1. Capital Issues* (i+ii)	228	4,529	3,214	2,495	1,254	4,977
i) Non-Government Public Ltd. Companies (a+b)	228	4,529	530	2,495	1,254	4,977
a) Bonds / Debentures	0	0	0	0	118	0
b) Shares	228	4,529	530	2,495	1,136	4,977
ii) PSUs and Government Companies	0	0	2,684	0	0	0
2. ADR / GDR / FCCBs +	770	597	872	721	789	739
3. External Commercial Borrowings (ECBs) $	12,199	3,860	11,084	11,744	3,026	-
4. Issue of CPs	1,819	421	1,901	963	3,562	1,928
C. Depreciation Provision	5,504	5,836	5,731	6,106	7,137	-
D. Profit after Tax	10,396	13,004	13,196	16,798	16,726	-

* : Gross issuances excluding issues by banks and financial institutions. Figures are not adjusted for banks' investments in capital issues, which are not expected to be significant.
\+ : Global Depository Receipts (GDRs)/American Depository Receipts (ADRs) and Foreign Currency Convertible Bonds (FCCBs) excluding issuances by banks and financial institutions.
$: Including short-term credit. @ : Data pertain to July-August 2005.
Note: Data are provisional.

their incremental investments in the corresponding period of the previous year. Consequently, commercial banks' holding of Government securities fell below 36 per cent of their net demand and time liabilities (NDTL) as on September 30, 2005 from nearly 40 per cent a year ago, but still substantially in excess of the statutory requirement of 25 per cent (Chart 15).

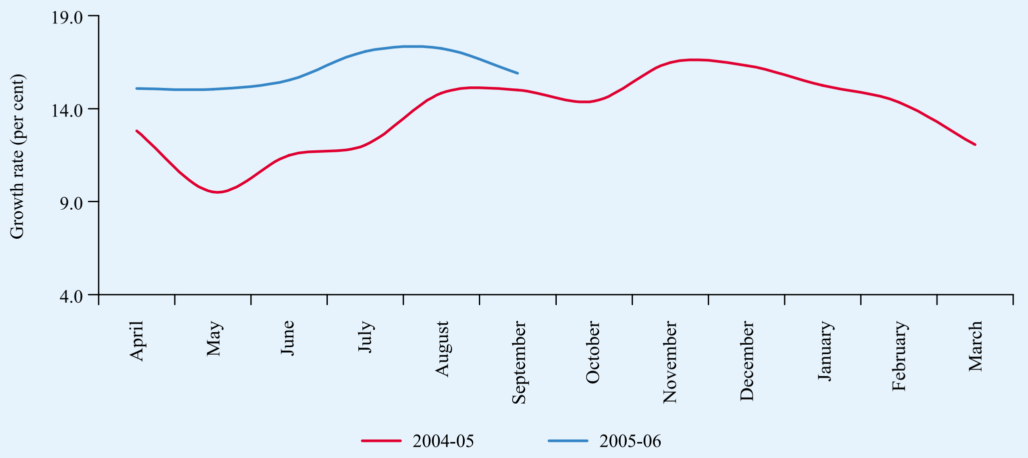
Chart 15: Net Bank Credit to Government



Reserve Money Survey

Reserve money growth as on October 14, 2005 at 17.9 per cent was almost the same as that a year ago (18.0 per cent), although the growth rate during 2005-06 till October 7, 2005 had remained consistently above that of 2004-05 (Chart 16). The higher growth in reserve money, despite broadly a similar order of accretion to the

Chart 16: Reserve Money Growth



Reserve Bank's net foreign exchange assets (NFEA) (net of revaluation) during the current fiscal, primarily reflected the relatively lower order of sterilisation operations. This, in turn, reflected a lower appetite for Government securities by the banking system in view of strong credit demand from the commercial sector. The higher order of expansion in the reserve money was also due to the impact of the increase in the cash reserve ratio (CRR) by 50 basis points during September-October 2004.

The Reserve Bank's foreign currency assets (net of revaluation) increased by Rs.29,544 crore during fiscal 2005-06 (up to October 14), comparable to that of Rs.30,604 crore during the corresponding period of 2004-05. Most of the increase in the NFEA was concentrated in the second quarter of the fiscal and consequently the quarter also witnessed liquidity absorption operations (Chart 17 and Table 18).

Chart 17: Accretion to RBI's Net Foreign Exchange Assets

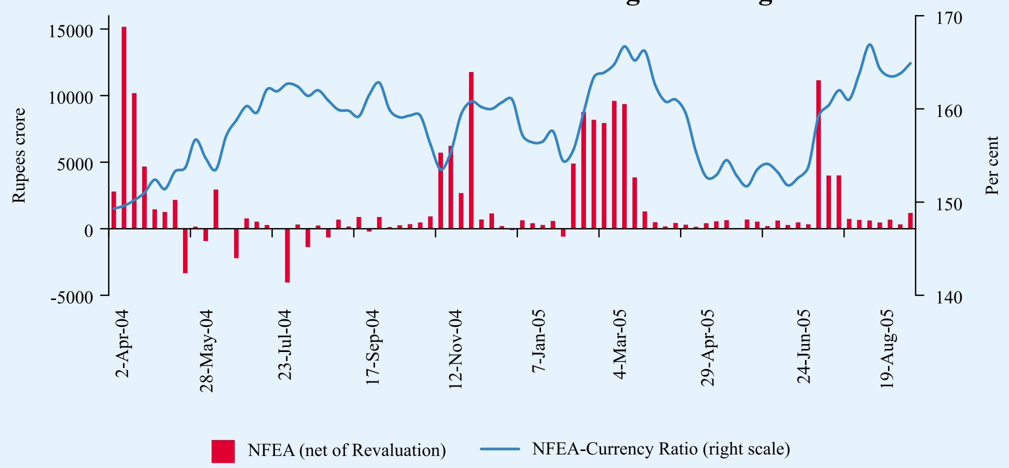


Table 18: Variation in Major Components and Sources of Reserve Money

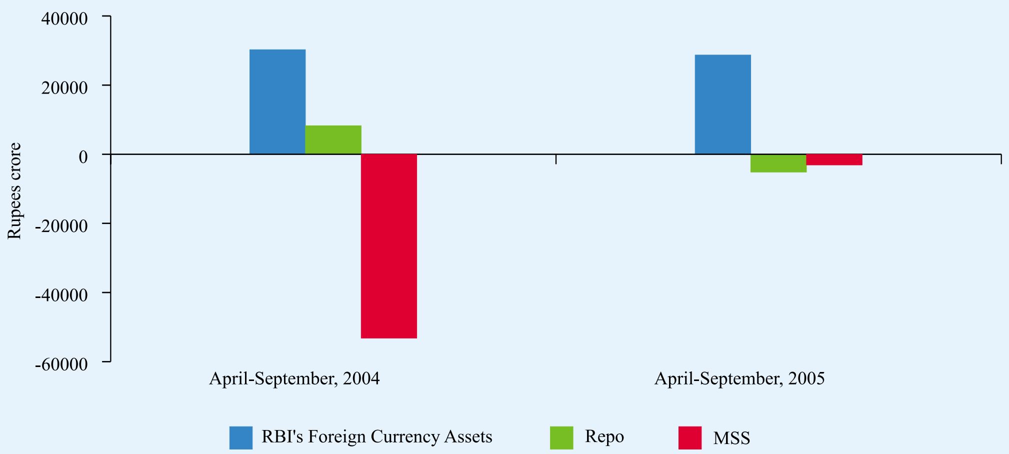
(Rupees crore)

Item	2004-05	2005-06 (up to Oct. 14)	2004-05				2005-06	
			Q1	Q2	Q3	Q4	Q1	Q2
1	2	3	4	5	6	7	8	9
Reserve Money	**52,623**	**28,557**	**-6,812**	**-6,285**	**31,546**	**34,174**	**6,856**	**159**
Components								
1. Currency in Circulation	41,633	22,516	14,317	-4,166	16,467	15,015	19,556	-10,378
2. Bankers' Deposits with RBI	9,631	7,431	-19,665	-2,874	14,769	17,401	-10,680	9,780
3. Other Deposits with RBI	1,359	-1,389	-1,463	755	310	1,757	-2,021	757
Sources								
1. RBI's net credit to Government	-62,882	6,641	-34,143	-6,179	184	-22,744	9,275	-25,251
of which: to Central Government	-60,177	11,897	-30,029	-4,499	203	-25,852	14,600	-25,251
2. RBI's credit to banks and commercial sector	-833	-1,377	-2,985	-740	3,726	-835	1,155	-1,869
3. NFEA of RBI	1,28,377	24,272	57,525	-5,260	31,462	44,651	-14,595	24,823
4. Government's Currency Liabilities to the Public	152	73	37	9	89	17	63	10
5. Net Non-Monetary Liabilities of RBI	12,191	1,052	27,245	-5,885	3,916	-13,085	-10,957	-2,446
Memo:								
1. Net Domestic Assets	-75,754	4,285	-64,336	-1,025	84	-10,477	21,450	-24,664
2. FCA adjusted for revaluation	1,15,044	29,544	33,160	-3,413	29,858	55,440	5,034	23,665
3. Net Purchases from Authorised Dealers	91,105	17,878 *	30,032	-9,789	22,771	48,091	0	17,878 *
4. NFEA/Reserve Money (per cent) (end-period)	125.3	123.1	126.1	126.7	124.9	125.3	120.6	125.6
5. NFEA/Currency (per cent) (end-period)	166.2	162.9	158.8	159.2	160.7	166.2	154.1	164.9

* : Up to August 26, 2005.
NFEA : Net Foreign Exchange Assets.
FCA : Foreign Currency Assets.
Note : Data are based on March 31 for Q4 and last reporting Friday for all other quarters.

Liquidity absorption operations during 2005-06 so far have mainly been in the form of reverse repo operations under the liquidity adjustment facility (LAF) in contrast to a heavy reliance on issuances under the market stabilisation scheme (MSS) during the comparable period of the preceding year (Chart 18).

Chart 18: Capital Flows and Liquidity Management



In the absence of any subscription to the Government's market borrowing programme, the Reserve Bank's net credit to the Centre reflected liquidity management operations of the Bank (Table 19). The Reserve Bank's net credit to the Centre increased by Rs.11,897 crore during 2005-06 (up to October 14) as against a substantial decline of Rs.21,395 crore during the comparable period of 2004-05.

Table 19: Net Reserve Bank Credit to the Centre - Variations

(Rupees crore)

Item	2004-05	2005-06 (up to Oct. 14)	2004-05				2005-06	
			Q1	Q2	Q3	Q4	Q1	Q2
1	2	3	4	5	6	7	8	9
Net Reserve Bank Credit to the Centre (1+2+3+4-5)	**-60,177**	**11,897**	**-30,029**	**-4,499**	**203**	**-25,852**	**14,600**	**-25,251**
1. Loans and Advances	0	0	3,222	-3,222	0	0	0	0
2. Treasury Bills held by the Reserve Bank	0	0	0	0	0	0	0	0
3. Reserve Bank's Holdings of Dated Securities	12,323	6,952	-2,900	22,176	14,095	-21,048	8,221	-17,243
4. Reserve Bank's Holdings of Rupee Coins	58	119	175	-11	-93	-15	-40	-33
5. Central Government Deposits	72,558	-4,826	30,525	23,443	13,799	4,791	-6,419	7,974
Memo *								
1. Market Borrowings of Dated Securities by the Centre #	80,350	84,000	28,000	26,000	14,000	12,350	42,000	39,000
2. Reserve Bank's Primary Subscription to Dated Securities	1,197	0	0	847	0	350	0	0
3. Repos (+) / Reverse Repos (-) (LAF), net position	15,315	10,075	-26,720	34,205	27,600	-19,770	9,660	-14,835
4. Net Open Market Sales £	2,899	2,521	429	427	871	1,171	1,543	941
5. Mobilisation under MSS	64,211	4,065	37,812	14,444	353	11,602	7,469	-4,353
6. Primary Operations $	-6,625	37,485	37,353	-30,484	-36,984	23,490	18,205	15,167

* : At face value. #: Excluding Treasury Bills.
£ : Excluding Treasury Bills and including operations under Consolidated Sinking Funds (CSF) and Other Investments.
$: Adjusted for MSS and Centre's surplus investment.
Note: Quarterly variations are based on March 31 for Q4 and last reporting Fridays for other quarters.

Liquidity Management

During 2005-06 so far (up to October 14, 2005), the Reserve Bank's operations to absorb liquidity from the system have been relatively moderate in view of the marked increase in merchandise trade deficit and the pick-up in domestic credit demand. Liquidity management operations during 2005-06 so far can be analysed in terms of three phases (Table 20). The first period – beginning end-March 2005 up to July 22, 2005 – did not witness purchases from the foreign exchange market by the Reserve Bank reflecting a sharp widening of the trade deficit. Moreover, the period also witnessed FII outflows during April-May 2005. Although FII inflows bounced back during June 2005, foreign

Table 20: Phases of Reserve Bank's Liquidity Management Operations

(Rupees crore)

Item	2004-05			2005-06		
	March 27 - May 14, 2004	May 15 - October 29, 2004	October 30, 2004 - March 31, 2005	April 1 - July 22, 2005	July 23 - August 12, 2005	August 13 - October 14, 2005
1	2	3	4	5	6	7
A. Drivers of Liquidity (1+2+3)	**37,170**	**-24,746**	**44,009**	**-6,959**	**28,014**	**-24,455**
1. RBI's Foreign Currency Assets (adjusted for revaluation)	37,919	-4,614	83,662	6,412	19,348	3,785
2. Currency with the Public	-20,021	6,365	-25,622	-14,828	-1,307	-5,360
3. Others (residual)	19,272	-26,497	-14,031	1,457	9,973	-22,880
3.1 Surplus cash balances of the Centre with the Reserve Bank	15,355	-18,481	-7,721	6,053	5,972	-12,666
B. Management of Liquidity (4+5+6+7)	**-40,148**	**37,960**	**-31,852**	**1,329**	**-24,567**	**35,090**
4. Liquidity impact of LAF Repos	-12,095	66,040	-11,875	8,845	-26,565	27,795
5. Liquidity impact of OMO (net)*	-277	-769	-1,853	0	0	0
6. Liquidity impact of MSS	-27,776	-27,311	-9,124	-7,516	1,998	7,295
7. First round liquidity impact due to CRR change	0	0	-9,000	0	0	0
C. Bank Reserves # (A+B)	**-2,978**	**13,214**	**12,157**	**-5,630**	**3,447**	**10,635**

+ : Indicates injection of liquidity into the banking system.
- : Indicates absorption of liquidity from the banking system.
: Includes vault cash with banks and adjusted for first round liquidity impact due to CRR change.
* : Adjusted for operations under Consolidated Sinking Funds (CSF) and Other Investments.

exchange markets were more or less balanced reflecting pressures from the trade deficit. During this phase, in the face of sustained credit demand, banks curtailed their incremental investments in the Government securities and reduced their operations under the Reserve Bank's reverse repo window. Consequently, the Reserve Bank injected primary liquidity through reversal of reverse repo operations.

During July 23 - August 12, following the revaluation of the Chinese currency, there were large foreign exchange inflows. Moreover, there was a reduction in the Centre's surplus investment balances. As a result, the balances under LAF reverse repo increased sharply from Rs.10,485 crore as on July 22 to Rs.37,050 crore as on August 12, peaking at Rs.50,610 crore on August 3, 2005. In the subsequent period (August 13 – October 14), again, accretion to the Reserve Bank's foreign exchange assets (net of revaluation) slowed down. Government surplus balances with the Reserve Bank started bouncing back leading to locking up of liquidity. Accordingly, the period witnessed injection of liquidity through reversal of reverse repos as balances under LAF were unwound (Table 21 and Chart 19).

Table 21: Liquidity Overhang

(Rupees crore)

Outstanding as on last Friday/March 31	LAF	MSS	Centre's Surplus with the RBI @	Total (2 to 4)
1	2	3	4	5
2004				
April	73,075	22,851	0	95,926
May	72,845	30,701	0	1,03,546
June	61,365	37,812	0	99,177
July	53,280	46,206	0	99,486
August	40,640	51,635	7,943	1,00,218
September	19,245	52,255	21,896	93,396
October	7,455	55,087	18,381	80,923
November	5,825	51,872	26,518	84,215
December	2,420	52,608	26,517	81,545
2005				
January	14,760	54,499	17,274	86,533
February	26,575	60,835	15,357	1,02,767
March	19,330	64,211	26,102	1,09,643
April	27,650	67,087	6,449	1,01,186
May	33,120	69,016	7,974	1,10,110
June	9,670	71,681	21,745	1,03,096
July	18,895	68,765	16,093	1,03,753
August	25,435	76,936	23,562	1,25,933
September	24,505	67,328	34,073	1,25,906
October*	9,255	68,276	26,743	1,04,274

* As on October 14, 2005. @ : Excludes minimum cash balance with the RBI.

Stable and comfortable liquidity conditions kept the call money rates close to the level of the reverse repo rate (Chart 20). With the increase in the fixed reverse repo rate from 4.75 per cent to 5.00 per cent, effective April 2005, call rates also edged up in the subsequent period. In view of comfortable liquidity

Chart 19: Liquidity Overhang

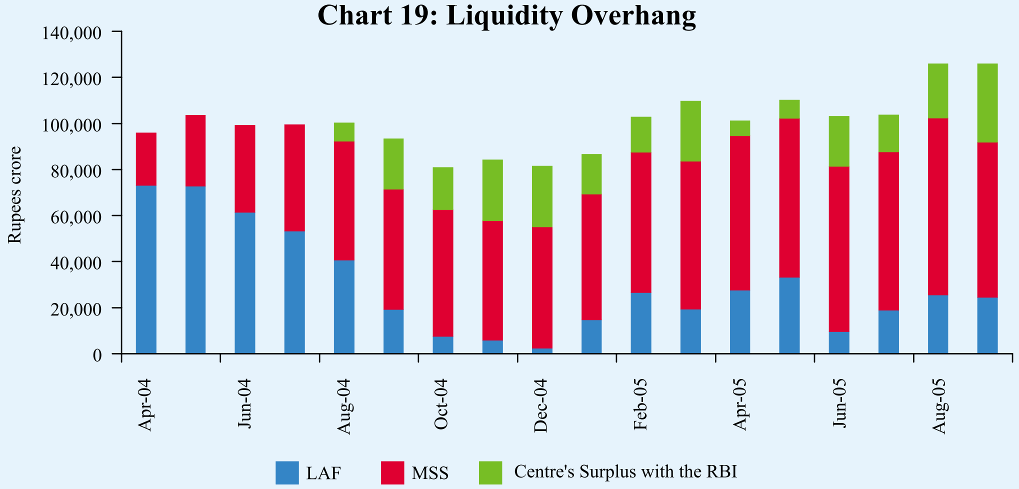
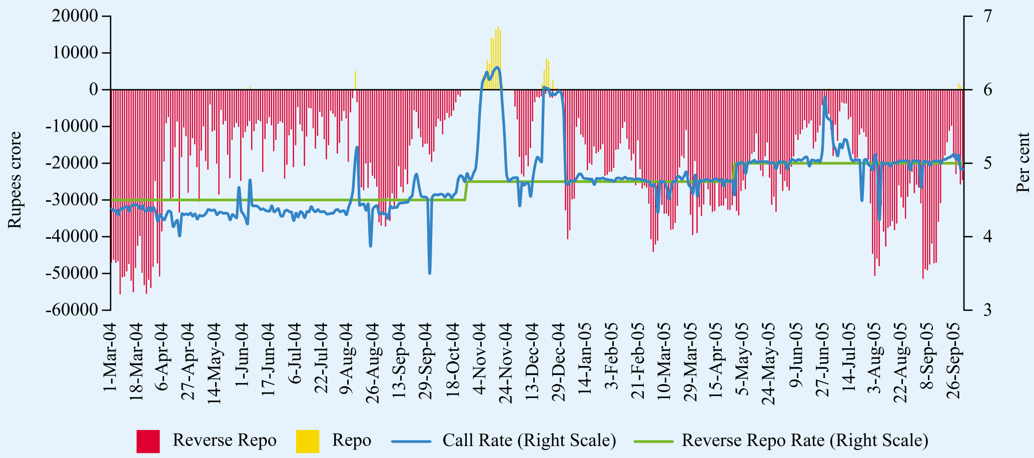


Chart 20: Liquidity Adjustment Facility and Call Rate



conditions, the Reserve Bank conducted LAF repos only on four occasions during 2005-06 (June 28, June 30, September 28 and September 29, 2005) of Rs.210 crore, Rs.575 crore, Rs.1,640 crore and Rs.1,000 crore, respectively. On a net basis, the Reserve Bank, however, absorbed liquidity even on those four days.

IV. PRICE SITUATION

Inflation pressures firmed up in a number of economies during the first half of 2005-06, reflecting the impact of further increases in international crude oil prices. Although international crude oil prices have reached record highs and a significant part of the increase is now increasingly viewed as somewhat permanent, the impact on economic activity and inflation expectations seems to have been largely contained till recently reflecting a variety of factors such as increased competition due to globalisation, fall in intensity of oil use in advanced economies, and continuous pre-emptive monetary tightening through measured increases in policy rates in a number of economies. However, in view of the sharp increase in consumer price inflation recently, the issue of changes in inflation expectations has been revived globally in the recent weeks.

In India, inflation eased further in the second quarter, despite continued dominance of supply-side factors. Fiscal and monetary measures undertaken since mid-2004 to reduce the impact of imported price pressures on domestic inflation and to stabilise inflationary expectations, coupled with the base effects and the revival of monsoon, enabled a moderation in the headline inflation rate during the first half of 2005-06. It needs to be recognised that the pass-through of high international crude oil prices to domestic prices remains incomplete**.**

Global Inflation

Reflecting the impact of continuing increases in international crude oil prices, consumer price inflation in developed countries is projected to edge up to 2.2 per cent in 2005 from 2.0 per cent in 2004 and its recent trough of 1.5 per cent in 2002. In developing Asia, although inflation is projected at 4.2 per cent in 2005, unchanged from 2004 - but double of 2.1 per cent recorded in 2002 - a number of economies in the region such as Thailand, the Philippines and Indonesia face large upward inflationary pressures from fuel prices. Even as inflation has remained firm, interest rate cycles across the world show a divergent trend reflecting the differences in the strength of economic activity. While the US, Canada, India, Korea, Thailand, Indonesia and the Philippines have raised their policy rates in the past six months, monetary policy has been eased in the UK, Brazil, Sweden and Poland. At the same time, accommodative stance continues in Japan and euro area to support economic recovery. However, in view of the sharp increase in consumer price inflation in September 2005, the European Central Bank while leaving the policy rates unchanged in its latest meeting held on October 6, 2005 stressed that strong vigilance with regard to upside risks to price stability is warranted, so that the increase in the current inflation rate does not translate into higher underlying inflationary pressures in the euro area.

In the US, consumer price inflation, which had decelerated to 2.5 per cent in June 2005, accelerated to 4.7 per cent by September 2005 due to sharp increase in energy costs. Core inflation (*i.e.*, excluding food and energy prices) after edging up during 2004 appears to have stabilised at around two per cent since early 2005. Reflecting the strong economic activity and the incipient inflationary pressures, the

Table 22: Inflation Indicators - Developed Economies

(Per cent)

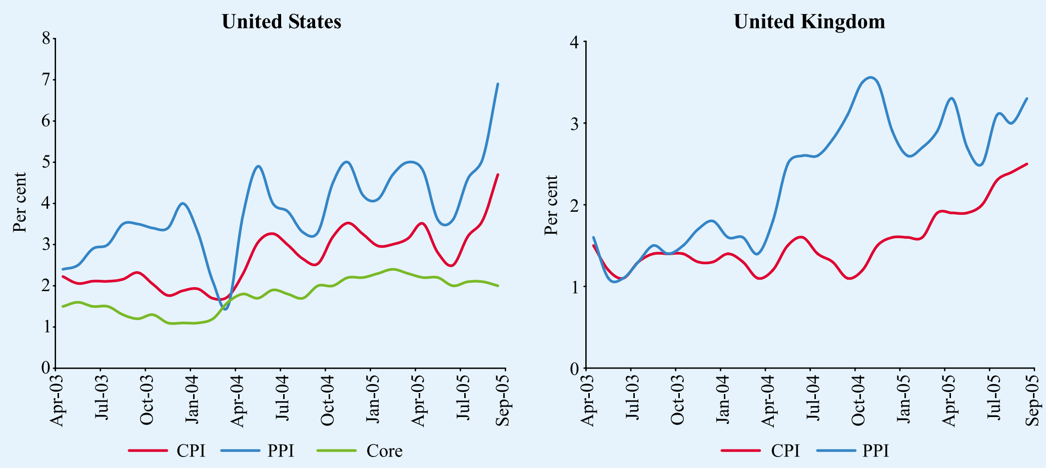
Country/ Region	Key Policy Rate/Bank Reserve Target	Policy Rates (Latest)	Changes in Policy Rates in basis points (January 2005 - October 19, 2005)	2004		2005 (Latest)	
				Inflation	Growth (y-o-y)	Inflation (September)	Growth (y-o-y) (Q_2)
1	2	3	4	5	6	7	8
Australia	Cash Rate	5.50	25	2.3	3.2	2.5 (Q2)	2.6
Canada	Overnight Rate	3.00	50	1.8	2.9	2.6 *	2.7
Euro area	Interest Rate on Main Refinancing Operations	2.00	Unchanged	2.1	2.0	2.6	1.1
Japan	Target Balance of Current Account	30-35 trillion yen	Unchanged	0.0	2.7	-0.3 *	1.4
New Zealand	Official Cash Rate	6.75	25	2.3	4.8	3.4 (Q3)	2.6 (Q2)
UK	Repo Rate	4.50	-25	1.3	3.2	2.5	1.5
US	Federal Funds Rate	3.75	150	2.7	4.2	4.7	3.6

* August.
Source : International Monetary Fund, websites of respective central banks and The Economist.

US Federal Reserve persevered with its measured pace of monetary tightening raising its target Federal Funds rate by a further 100 basis points since end-March 2005 (25 basis points hike at each of its four meetings) to take the Fed Funds rate to more neutral levels (Table 22). According to the US Federal Open Market Committee (FOMC), although higher energy and other costs have the potential to add to inflation pressures, longer-term inflation expectations in the US remain well contained. The FOMC has thus continued to remove policy accommodation at a measured pace.

In the UK, CPI inflation accelerated to 2.5 per cent in September 2005 – the highest rate since January 1997 – driven up by higher oil prices, catching up with producer price inflation (Chart 21). The Bank of England, however, cut the policy repo rate by 25 basis points on August 4, 2005 in response to the weakening of

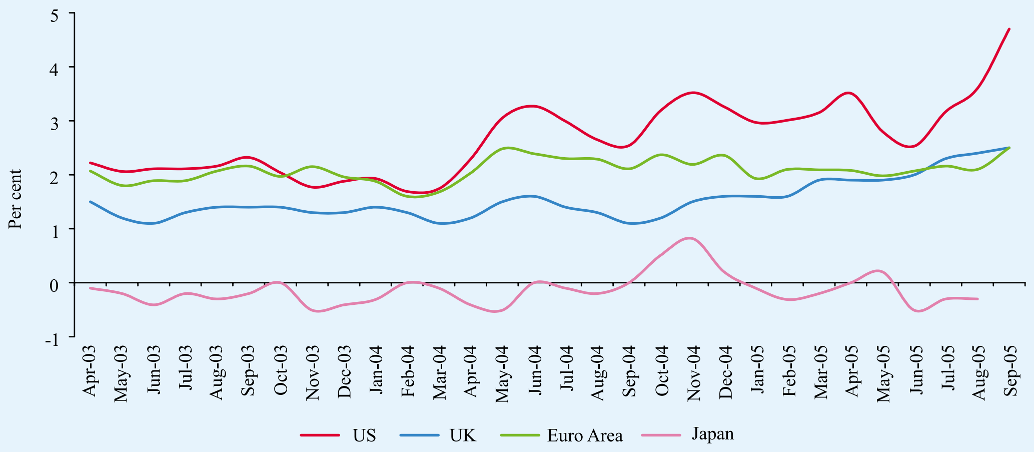
Chart 21: Consumer and Producer Price Inflation (year-on-year)



economic activity. As pressures from labour costs remained contained, risks to inflation are seen as weighted slightly to the downside in the medium term.

Euro area inflation, measured by the Harmonised Index of Consumer Prices (HICP), led by high oil prices increased to 2.6 per cent in September 2005 - exceeding the target of 'close to 2.0 per cent' (Chart 22). Taking into account the potential second-round effects in wage and price setting behaviour triggered by ongoing oil price rises, the European Central Bank (ECB) has chosen to maintain its existing monetary policy stance (unchanged since March 2003) even as economic activity is likely to weaken in 2005.

Chart 22: Consumer Price Inflation - Developed Economies

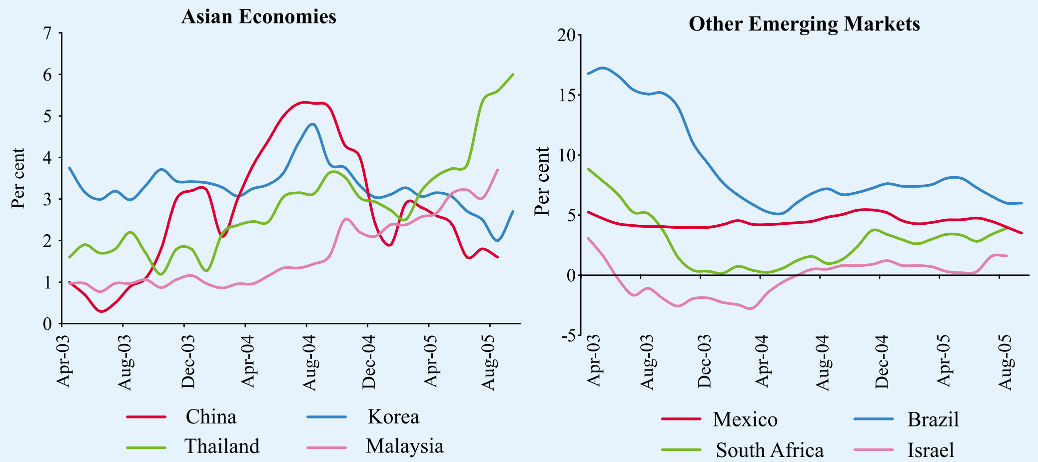


In Japan, mild deflation continues. Consumer prices, year-on-year, declined by 0.3 per cent in August 2005 as compared with a decline of 0.2 per cent a year ago. Producer price inflation remained steady at 1.7 per cent in August 2005 due to higher oil prices. With annual rate of change in consumer prices projected to be nil or a slight increase towards the end of the year, the Bank of Japan (BoJ) persisted with the target range for bank reserves at 30-35 trillion yen set since January 2004 while allowing the balance of current accounts with it to fall short of the target in case of weak liquidity demand.

In China, producer price inflation (y-o-y) increased to 5.3 per cent in August 2005 driven up by higher crude oil prices (36.2 per cent). On the other hand, consumer price inflation decelerated to 1.6 per cent in August 2005 from 5.3 per cent a year ago, due to a decline in prices of food items and clothing as well as incomplete pass through of higher oil prices to domestic oil prices (Chart 23). Various administrative and monetary measures by the People's Bank of China (PBC) have been able to moderate money and credit growth.

Amongst other Asian economies, inflation in Indonesia increased to 9.1 per cent in September 2005, driven up by increases in administered fuel prices and currency depreciation. With inflation expected to be 9 per cent in 2005 – above

Chart 23: Consumer Price Inflation: Emerging Economies



the medium-term inflation target of 6 (+/-1) per cent - and continued uncertainty over world oil prices, the Bank Indonesia raised the policy rate by a further 150 basis points - 50 basis points on September 6, 2005 and another 100 basis points on October 4, 2005 - to 11.0 per cent. In the Philippines too, CPI inflation at 7.0 per cent in September 2005 remains above the target of 4-5 per cent. With supply-side inflation pressures expected to build up further over the policy horizon through the second-round effects of higher oil prices, the Bank of Philippines raised the policy reverse repo rate further by 25 basis points on September 22, 2005. In Thailand, both headline (6.0 per cent) and core (2.3 per cent) inflation accelerated in September 2005 driven up by persistent increases in oil prices. With growth momentum remaining strong and probability of core inflation exceeding the target range (0-3.5 per cent) due to increasing oil prices, the Bank of Thailand raised policy interest rates further by 100 basis points - 50 basis points each on September 7 and October 19, 2005 - to 3.75 per cent (Table 23). In Korea, although inflation at 2.7 per cent in September 2005 (3.9 per cent a year ago) was below the target, inflationary pressures are seen due to the persistently high oil prices. The Bank of Korea accordingly reversed its accommodative stance pursued since November 2004 and raised the policy rate by 25 basis points to 3.50 per cent on October 11, 2005.

To conclude, inflation pressures have increased in a number of economies during 2005-06 so far. However, despite large oil price increases during 2004 and 2005, the rise in global consumer price inflation has been relatively muted so far compared to the earlier oil shocks. This reflects a number of factors: the declining role of commodity prices in final output and reduced intensity of oil use, especially in advanced economies; heightened competition brought about by forces of globalisation and increased deregulation; and, finally, better anchored inflation expectations have so far mitigated the second round effects of the oil price hikes. Another reason as to why headline inflation has been muted so far is that the pass-through from international prices to

Table 23: Inflation Indicators – Developing Economies

(Per cent)

Country/ Region	Key Policy Rate/Bank Reserve Target	Policy Rates (Latest)	Changes in Policy Rates in basis points (January 2005 - October 19, 2005)	2004 Inflation	2004 Growth (y-o-y)	2005 (Latest) Inflation (September)	2005 (Latest) Growth (y-o-y) (Q2)
1	2	3	4	5	6	7	8
Brazil	Selic Rate	19.50	175	6.6	4.9	6.0	3.9
China	M2			3.9	9.5	1.6 *	9.5
India	Reverse Repo Rate	5.00	25	3.8	6.9 #	3.4 *	8.1
Israel	Key Rate	3.75	(-) 15	-0.4	4.4	1.6 *	4.8
Korea	Overnight Call Rate	3.50	0.25	3.6	4.6	2.7	3.3
Mexico	Reserve Requirement (Peso short position)	79 million pesos	10 million (tightened)	4.7	4.4	3.5	3.1
Philippines	Reverse Repo Rate	7.25	50	6.0	6.0	7.0	4.8
South Africa	Repo Rate	7.00	(-) 50	1.4	3.7	3.9 *	4.5
Thailand	14-day Repo Rate	3.75	175	2.7	6.1	6.0	4.4

* August. # Fiscal year 2004-05.

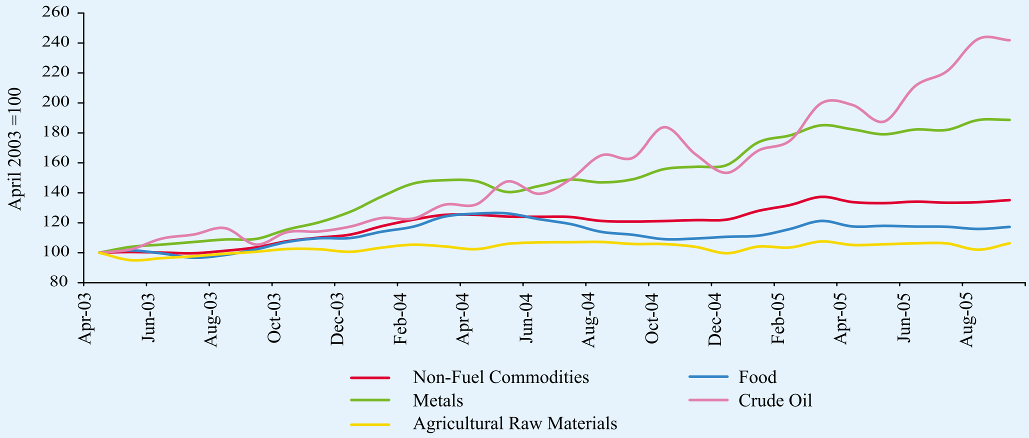
Source : International Monetary Fund, websites of respective central banks and The Economist.

domestic prices of oil has been less than complete due to sharing of the burden by the Governments, especially in a number of emerging economies. However, with oil prices continuing their upward movement, the policy of low pas-through to domestic oil prices poses risks to fiscal health and macroeconomic stability. Furthermore, it also discourages efficiency in use of oil. Many countries have, therefore, begun to pass on higher oil prices to domestic consumers.

Global Commodity Prices

Continuous upward movements in international crude oil prices to record highs have dominated global commodity markets since early 2004 (Chart 24). Non-fuel commodity prices, on the other hand, which had moved up again during the last quarter of 2004-05 led by sharp increases in metals prices appear to

Chart 24: International Commodity Prices

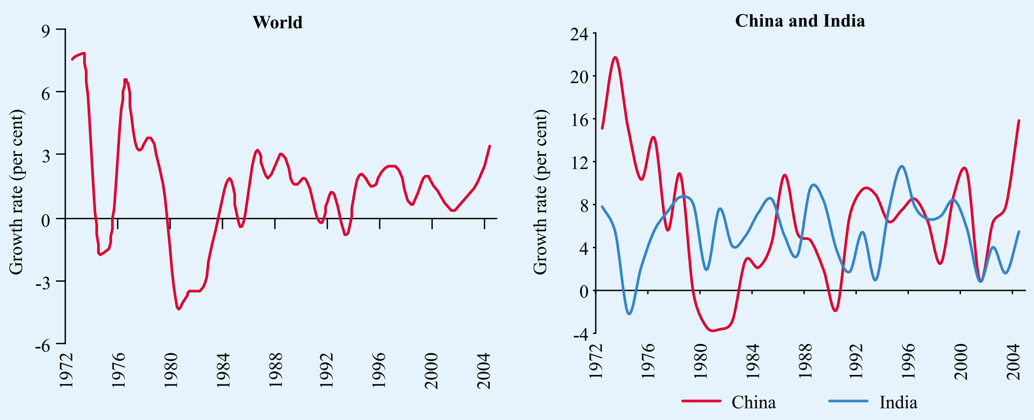


Source: International Monetary Fund.

have stabilised, *albeit* at elevated levels, during April-September 2005. The IMF's non-fuel commodity price index declined by 1.6 per cent in September 2005 over March 2005 and year-on-year growth in the index slowed down to 11.8 per cent in September 2005 from 16.7 per cent a year ago.

Strong growth in global demand, lags in developing new supply and economic resilience to higher energy costs have supported oil prices at elevated levels despite periodic increases in supply by the Organisation of the Petroleum Exporting Countries (OPEC). Global demand for oil is estimated to have increased sharply from less than one per cent during 2002 to 3.2 per cent during 2004 – the fastest rate of growth since 1978 (Chart 25). In particular, Chinese oil demand increased by around 16 per cent during calendar year 2004 contributing one third of incremental global demand.

Chart 25: Oil Consumption



Source: BP Statistical Review of World Energy, 2005.

In an environment of strong demand and historically low levels of global spare production capacity, temporary supply disruptions due to tropical storms in the US (more recent being the hurricanes Katrina and Rita during August-September 2005) and concerns over stability of supplies from the Middle East due to geo-political uncertainties further added to nervousness in the world oil market. Besides fundamentals, speculative positions, which often react disproportionately to relatively minor supply shocks, have imparted a great deal of volatility to oil prices. Reflecting all these factors, international crude oil prices surged further in 2005-06, touching successive record highs in recent months. The US West Texas Intermediate (WTI) crude prices rose to a historical high of US $ 70.8 a barrel on August 30, 2005 in the immediate aftermath of Hurricane Katrina. Prices, however, moderated somewhat to around US $ 65 a barrel by end-September, 2005 reflecting concerted efforts by the International Energy Agency (IEA) to release emergency stocks of 2 million barrels a day (mb/d) of crude and products to compensate for the outage in the US Gulf Coast due to the Hurricane Katrina. The decision by the OEPC in its Vienna meeting during September 19-20, 2005 to make available existing spare capacity in member countries of around 2 mb/d for a three-month period and further signs of slowing global demand growth also helped moderate prices. On the whole, over the past one and a half year, international crude oil prices have surged by 83 per cent from US $ 33.7 per barrel in March 2004 to US $ 61.7 per barrel in September 2005 (Table 24). Dubai crude prices which were subdued during June-October 2004 relative to the increase in the prices of US WTI have risen faster since January 2005, narrowing the gap in pricing between markets.

Table 24: International Crude Oil Prices

(US dollars per barrel)

Item	2002-03	2003-04	2004-05	March 2005	June 2005	September 2005
1	2	3	4	5	6	7
Dubai Crude	25.9	26.9	36.4	45.6	51.0	56.5
UK Brent	27.6	29.0	42.2	53.1	54.3	63.0
US WTI	29.2	31.4	45.0	54.2	56.4	65.5
Average Crude Price	**27.6**	**29.1**	**41.3**	**50.9**	**53.9**	**61.7**
Memo item:						
Indian Basket Price	**26.6**	**27.8**	**38.9**	**48.8**	**52.4**	**59.3**

Sources : International Monetary Fund and the World Bank.

The Gulf of Mexico coast region is a major oil and natural gas supply centre for the United States with significant offshore oil and natural gas production, refining capacity, and petrochemical facilities, and serves as a major import hub and nexus for pipeline infrastructure. The recent hurricanes have caused significant direct damage to offshore rigs, refineries, pipelines, and ports in the Gulf of Mexico. The hurricane season is not yet over and the severity and location of hurricanes over the next few months could continue to influence world oil markets. With limited spare global crude oil production capacity and the U.S. oil production and refining industries still to recover, oil prices are likely to react sharply to any additional disruption of or damage to petroleum infrastructure (Table 25). The continued geo-political risks, such as the insurgency in Iraq and potential troubles in Nigeria

Table 25: World Supply-Demand Balance of Oil

(Million barrels per day)

Item	2002	2003	2004	2005 (P)	2005			
					Q1	Q2	Q3 (P)	Q4 (P)
1	2	3	4	5	6	7	8	9
Demand								
1. OECD	47.9	48.7	49.5	49.6	50.4	48.6	49.4	50.0
2. Non-OECD	30.4	31.2	33.0	34.1	33.6	33.7	33.9	35.3
-China	5.2	5.6	6.5	6.9	6.7	6.9	7.0	7.2
A. Total (1+2)	**78.4**	**79.9**	**82.5**	**83.7**	**83.9**	**82.3**	**83.3**	**85.3**
Supply								
3. Total Non-OPEC	47.9	48.9	50.1	50.2	50.4	50.6	49.7	49.9
4. OPEC	29.0	30.7	32.9	34.1	33.7	34.0	34.3	34.5
B. Total (3+4)	**76.9**	**79.6**	**83.0**	**84.3**	**84.2**	**84.6**	**84.0**	**84.4**

P : Projections.
Source : US Energy Information Administration, October 2005.

and Venezuela, have boosted the level of uncertainty in world oil markets. The consensus at the present moment thus appears to be that oil prices would remain at elevated levels at around US $ 60 per barrel or above.

Turning to non-fuel group, agricultural commodity prices eased during April-September 2005 on improved crop prospects/stocks. As the global production of wheat and coarse grains is likely to decline due to adverse weather conditions, prices are expected to remain firm. Rice prices are also expected to remain firm despite higher production due to rising production and marketing costs associated with the surge in oil prices.

Prices of oilseeds and oilseed-based products which had edged up from March 2005 in reaction to sudden deterioration of production prospects in South America eased in August-September 2005 with the waning of weather concerns in the main producing regions of North and South America and excess supplies continuing to dominate market conditions. On the other hand, notwithstanding some easing in August-September 2005, prices of edible oils and fats are expected to remain firm due to strong consumption demand, especially from China and India, demand for non-food uses like bio diesel from the EU and the US and below average stock levels.

Sugar prices after easing somewhat during April-June 2005 on the back of upward revision in estimates for global production during the 2004-05 season (October-September) edged up again during the second quarter. Free market sugar prices in the international market increased by 21.5 per cent between March 2005 and September 2005. Despite improved production prospects in India, shortfall in production in China is likely to keep prices at elevated levels in the coming months.

Global cotton prices declined further by about two per cent between March 2005 and September 2005 on top of a decline of 15.6 per cent during 2004-05 (April-March), reflecting a rebound in production. However, the lower prices have curtailed plantings and this, coupled with less favourable weather, is expected to result in a decline in world production during 2005-06. The International Cotton Advisory Committee (ICAC), therefore, expects prices to harden by about 19 per cent in 2005-06 in view of the tight balance between demand and supply conditions.

Metal prices firmed up further in the first half of 2005-06 on the back of robust construction and manufacturing demand from China and the US. Steel prices eased somewhat during July 2005 on the back of strong increase in Chinese production, higher inventories in the US and sluggish demand in Japan (Table 26). Prices, however, edged up again due to supply management efforts by steel producers in Europe in the form of production cuts and are likely to remain at elevated levels due to demand from China and higher raw material costs. With inventories falling to historical lows, copper prices continue to remain firm - prices increased by 14 per cent between March 2005 and September 2005 on top of an increase of about 47 per cent during 2004-05.

Table 26: World Commodity Prices

(Index 1995=100)

Commodity / Group	2002-03	2003-04	2004-05	March 2005	June 2005	September 2005
1	2	3	4	5	6	7
All Commodities	**113.5**	**122.6**	**161.2**	**189.3**	**195.5**	**216.3**
A. Fuel	**151.4**	**162.3**	**228.7**	**276.8**	**292.6**	**335.1**
Crude Oil	160.2	169.1	239.8	296.0	313.2	358.4
Average Crude Price (US $/barrel)	27.6	29.1	41.3	50.9	53.9	61.7
Coal (US $/tonne)	26.2	32.3	56.8	52.7	52.8	47.0
B. Non-fuel Commodities	**78.8**	**86.1**	**99.4**	**109.1**	**106.5**	**107.4**
Metals	73.0	88.1	116.2	136.8	134.7	139.4
Steel Products #	70.4	85.2	129.6	136.9	142.2	138.6
Agricultural Raw Materials	80.6	82.1	85.7	87.8	86.8	86.8
Cotton (Cotlook 'A Index')	50.3	67.3	56.8	56.2	54.0	54.9
Food Products	83.8	89.6	97.8	101.7	98.6	98.4
Rice (US $/tonne)	193.5	204.9	263.7	295.0	287.0	287.4
Wheat (US $/tonne)	154.5	150.5	153.7	151.0	141.9	159.7
Sugar (Free Market) (US cents per pound)	6.7	6.5	8.3	8.9	9.0	10.8
Palm Oil (US $/tonne)	384.5	430.9	399.7	374.8	369.6	370.0
Soybean Oil (US $/tonne)	436.8	560.4	532.5	513.1	529.7	496.9

World Bank's composite price index for eight steel products (Base 1990=100).
Source : International Monetary Fund and the World Bank.

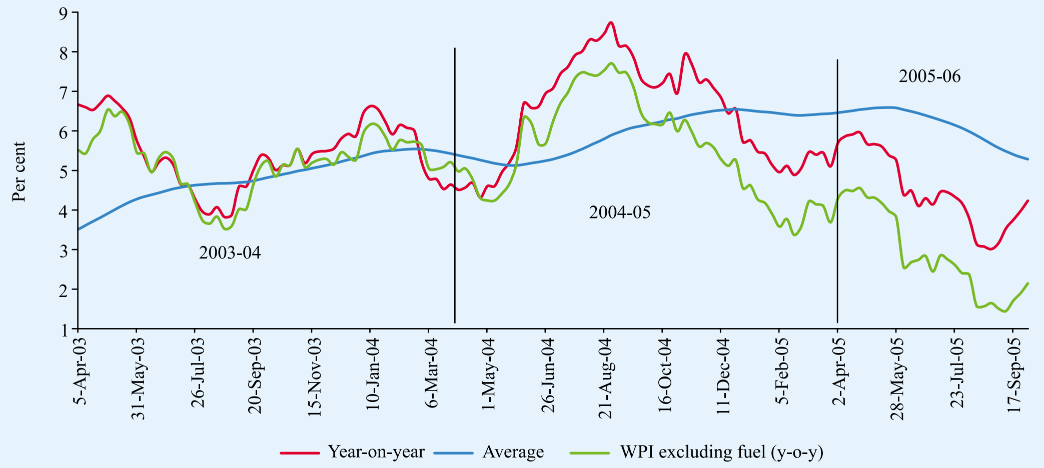
Inflation Conditions in India

Headline inflation, measured by year-on-year (y-o-y) changes in the wholesale price index (WPI), moderated during the second quarter of 2005-06. WPI inflation eased to 4.2 per cent by October 1, 2005 – after touching an intra-year low of 3.0 per cent on August 30, 2005 - from 5.1 per cent at end-March 2005 (and 7.2 per cent a year ago). The average WPI inflation rate eased to 5.3 per cent on October 1, 2005 from 6.2 per cent a year ago and 6.5 per cent at the beginning of the year.

Despite hikes in petrol and diesel prices (7-8 per cent each in June and September 2005) and increase in electricity prices in June 2005, the moderation in headline inflation was due to monetary and fiscal measures; easing of primary articles prices following the recovery of the South-West monsoon; and base effects of higher prices in the previous year. Monetary measures - increases in cash reserve ratio (50 basis points during September-October 2004) and reverse repo rate (25 basis points each in October 2004 and April 2005) - sought to moderate inflationary expectations by demonstrable commitment to price stability.

Inflation outcome during 2005-06 so far has been dominated by the supply-side factors. The y-o-y WPI inflation excluding the fuel group was significantly lower at 2.1 per cent on October 1, 2005 and for the past year, it has remained around 1.5-2.0 percentage points below the headline inflation (Chart 26). However, when a significant part of what may be considered as permanent component of oil price increase is yet to be passed on, there is a need to consider two factors. First, the

Chart 26: Annual Wholesale Price Inflation



advisability of treating the oil price increase as a shock rather than a permanent shift in relative prices may need to be questioned; and second, the inevitability of second order effects on inflation needs to be taken on board.

Prices of iron and steel, petroleum products and electricity - with a combined weight of around 16 per cent in the WPI basket - together contributed about 70 per cent of the headline inflation rate of 4.2 per cent on October 1, 2005. Minerals oil inflation alone contributed about one-half of the headline inflation (Table 27).

Domestic prices of petrol and diesel, which were revised upwards by about 7-8 per cent effective June 21, 2005 after a gap of almost seven months, were raised by almost a similar magnitude effective September 7, 2005. Even after this increase, domestic PoL prices have been lagging the increase in international oil prices (Chart 27). International crude oil prices (the Indian basket) increased by about 86 per cent between March 2004 and September 2005 from US $ 31.9 a barrel to US $ 59.3 a barrel. Over the same period, domestic mineral oil prices increased by about 30.0 per cent - petrol by 28.1 per cent and diesel by 38.2 per cent, with the burden being shared by the oil companies and the Central Government.

Cross-country analysis of pass-through shows that, between March 2004 and September 2005, domestic retail prices (including tax) (in US dollar terms) of petrol have increased ranging from 20.7 per cent (Italy) to 64.3 per cent (USA). The increase in diesel prices ranged between 25.2 per cent (UK) and 70.5 per cent (USA). In comparison, India's domestic retail prices of petrol and diesel (average of four metros) increased by 26.4 per cent and 36.3 per cent, respectively. As a measure of the pass-through of international oil prices to domestic prices, the comparison of the change in domestic retail prices (inclusive of the tax component) is complicated by the tax component which varies from country to country - it is as high as 60-65 per cent of retail price of gasoline in European

Table 27: Wholesale Price Inflation in India (year-on-year)

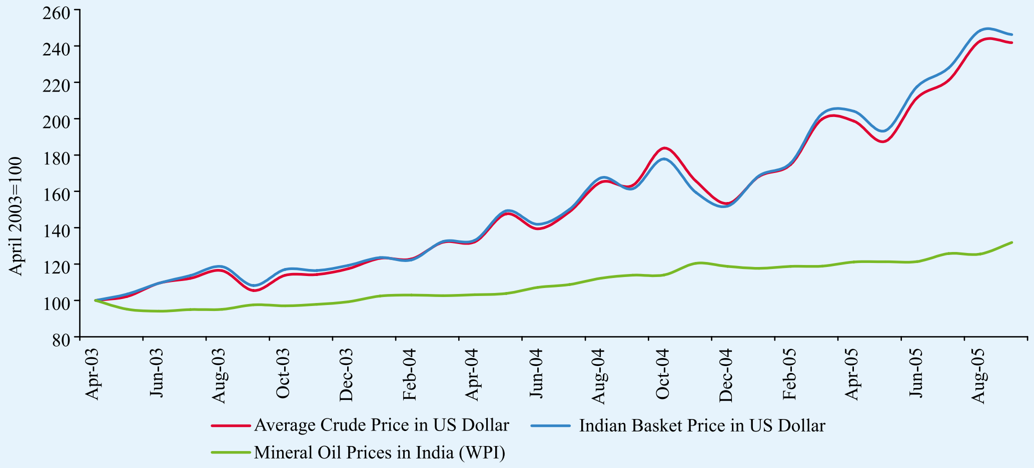
(Per cent)

Commodity	Weight	2004-05 Inflation	2004-05 WCs	2004-05 (October 2) Inflation	2004-05 (October 2) WCs	2005-06 P (October 1) Inflation	2005-06 P (October 1) WCs
1	2	3	4	5	6	7	8
All Commodities	**100.0**	**5.1**	**100.0**	**7.1**	**100.0**	**4.2**	**100.0**
1. Primary Articles	**22.0**	**1.3**	**5.5**	**4.3**	**13.6**	**1.8**	**9.4**
Food Articles	15.4	3.0	8.9	1.8	4.0	4.1	14.8
i. Rice	2.4	2.9	1.3	-1.4	- 0.5	4.1	2.1
ii. Wheat	1.4	-1.1	-0.3	3.9	0.8	1.6	0.5
iii. Pulses	0.6	-2.6	-0.3	1.8	0.2	5.1	0.7
iv. Vegetables	1.5	11.9	2.3	1.4	0.3	3.5	1.3
v. Fruits	1.5	11.5	4.1	-0.8	-0.2	5.5	2.3
vi. Milk	4.4	-1.7	-1.5	4.0	2.5	0.4	0.4
vii. Eggs, Fish and Meat	2.2	7.3	3.1	0.9	0.3	14.7	7.6
Non-Food Articles	6.1	-6.9	-8.8	4.1	3.7	-4.3	-6.2
i. Raw Cotton	1.4	-23.8	-6.5	-5.4	-1.0	-15.5	-4.5
ii. Oil Seeds	2.7	-6.5	-3.4	8.8	3.2	-6.2	-3.8
iii. Sugarcane	1.3	-0.7	-0.2	5.1	1.1	0.6	0.2
Minerals	0.5	68.0	5.3	131.5	5.9	4.4	0.7
i. Iron Ore	0.2	119.1	5.2	290.6	6.1	4.1	0.5
2. Fuel, Power, Light and Lubricants	**14.2**	**10.5**	**42.7**	**10.8**	**30.8**	**12.0**	**60.1**
i. Mineral Oils	7.0	16.0	34.9	16.9	25.4	17.7	49.1
ii. Electricity	5.5	0.8	1.2	0.8	0.9	6.2	10.7
iii. Coal Mining	1.8	17.1	6.4	16.3	4.5	0.7	0.4
3. Manufactured Products	**63.7**	**4.6**	**52.0**	**7.0**	**55.1**	**2.3**	**30.3**
i. Food Products	11.5	0.4	0.9	5.2	8.0	0.1	0.1
Of which: Sugar	3.6	19.7	10.3	15.6	5.7	10.0	6.6
Edible Oils	2.8	-8.4	-4.0	2.3	0.8	-7.8	-4.3
Oil Cakes	1.4	-17.4	-6.4	-4.6	-1.2	-12.9	-5.1
ii. Cotton Textiles	4.2	-12.7	-10.4	6.8	3.7	-13.4	-12.2
iii. Man Made Fibre	4.4	0.6	0.3	6.0	1.9	-6.9	-3.7
iv. Chemicals and Chemical Products	11.9	3.9	9.1	3.2	5.3	3.0	8.2
Of which : Fertilisers	3.7	3.3	2.2	0.4	0.2	3.1	2.4
v. Basic Metals, Alloys and Metal Products	8.3	17.1	28.4	19.9	22.5	8.5	18.1
Of which: Iron and Steel	3.6	21.3	17.0	26.5	14.3	9.1	9.8
vi. Non-Metallic Mineral Products	2.5	11.4	4.7	7.9	2.3	7.7	3.8
Of which: Cement	1.7	10.2	2.9	6.0	1.2	9.3	3.1
vii. Machinery and Machine Tools	8.4	7.1	8.6	6.3	5.6	4.1	6.1
viii.Transport Equipment and Parts	4.3	6.2	4.3	6.4	3.2	2.6	2.2
Food Items (Composite)	**26.9**	**1.9**	**9.8**	**3.1**	**12.0**	**2.4**	**15.0**
WPI Excluding Food	**73.1**	**6.3**	**90.2**	**8.7**	**88.0**	**4.9**	**85.0**
WPI Excluding Fuel	**85.8**	**3.7**	**57.3**	**6.2**	**69.2**	**2.1**	**39.9**

P : Provisional. WCs : Weighted Contributions.

countries such as France, Germany and the UK. On the other hand, the share of taxes at 14 per cent is fairly low for the US. Excluding the tax component, data for select countries show that the pass-through to domestic gasoline and diesel prices is substantially higher at around 80-90 per cent (Table 28).

Chart 27: Oil Prices



Domestic iron and steel prices increased during the first quarter of 2005-06 following the hikes in steel prices announced by various companies in April 2005. In line with easing trend in international metals prices during May-June 2005 and rising inventories, domestic companies announced cuts/rebates of about 10-12 per cent in prices of select products during June-July 2005. As international prices recovered on the back of production cuts by major steel producers, domestic

Table 28: Change in Average End-use Petroleum Products Prices: September 2005 over March 2004

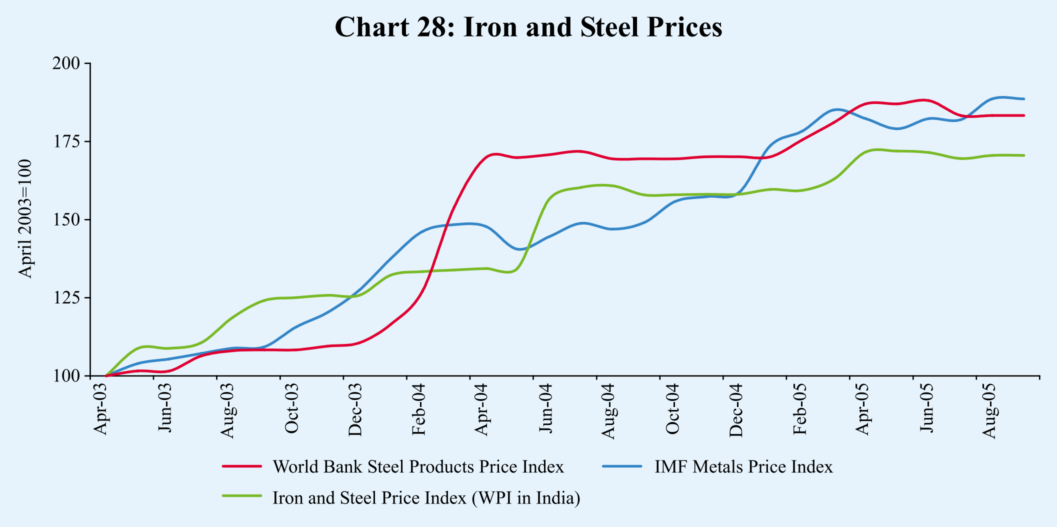
(Per cent)

Sr. No.	Country	Gasoline Prices: In National Currency: Including Tax	Gasoline Prices: In National Currency: Excluding Tax	Gasoline Prices: In US Dollar: Including Tax	Gasoline Prices: In US Dollar: Excluding Tax	Automotive Diesel: In National Currency: Including Tax	Automotive Diesel: In National Currency: Excluding Tax	Automotive Diesel: In US Dollar: Including Tax	Automotive Diesel: In US Dollar: Excluding Tax
1	2	3	4	5	6	7	8	9	10
1.	France	24.5	77.8	25.0	78.5	32.9	82.8	33.4	83.6
2.	Germany	23.9	78.7	24.4	79.7	29.7	79.2	30.2	79.8
3.	Italy	20.2	51.6	20.7	52.4	33.2	70.1	33.8	70.8
4.	Spain	29.1	65.6	29.6	66.1	38.8	76.1	39.3	76.8
5.	UK	24.4	77.7	23.9	77.1	25.8	79.2	25.2	78.3
6.	Japan	31.0	67.1	28.6	63.8	30.8	51.1	28.4	48.3
7.	Canada	45.3	70.3	63.6	91.6	41.0	56.0	58.6	75.8
8.	USA	64.3	82.8	64.3	82.8	70.5	97.4	70.5	97.4
9.	Thailand	63.3	85.0	56.7	77.5	65.8	90.7	59.1	83.1
10.	China *	14.6		14.1		15.1		15.4	
11.	Korea @	3.8		17.9		21.8		38.7	
12.	**India**	**28.1**		**26.4**		**38.2**		**36.3**	

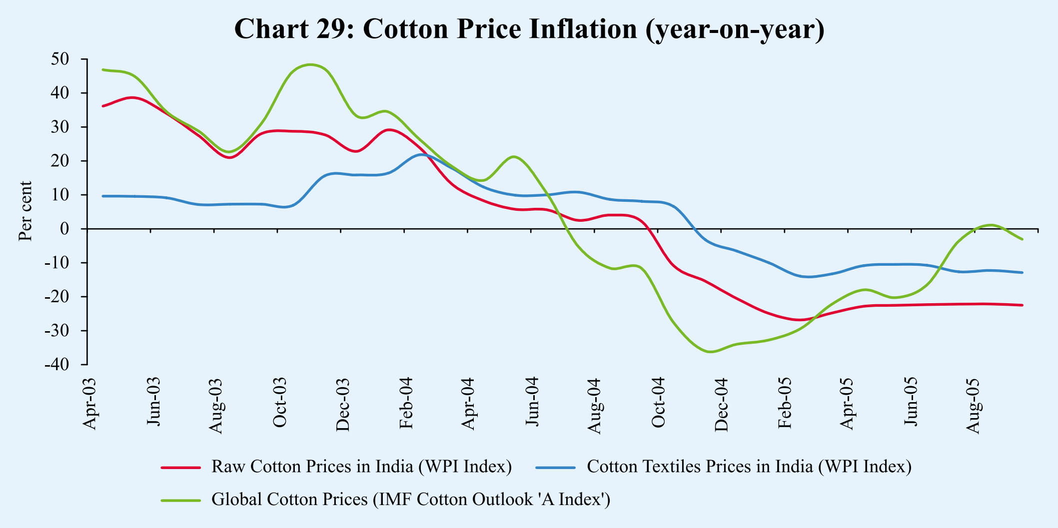
* : Between March 2004 and February 2005 @ : Between March 2004 and June 2005.

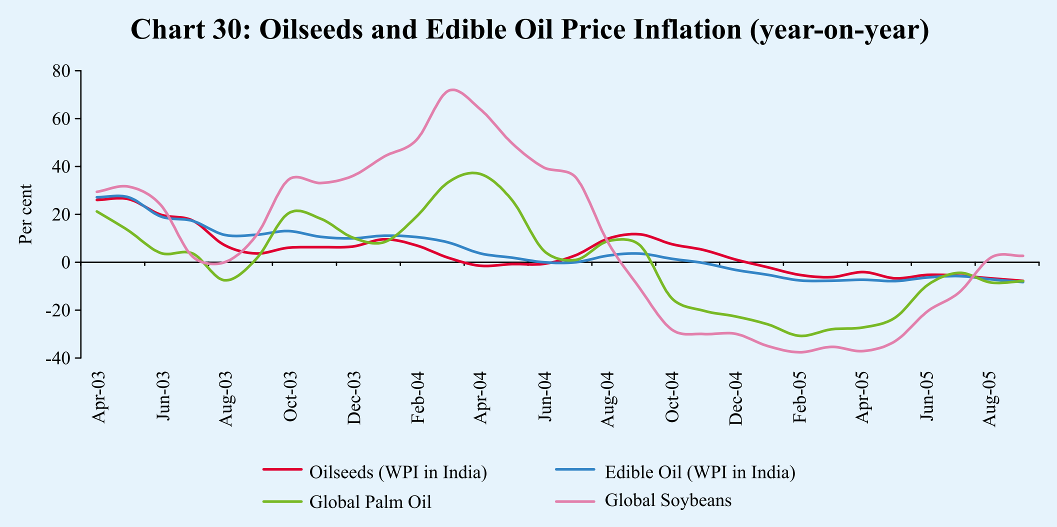
Source: International Energy Agency (IEA); Indian Oil Corporation Ltd.; Korea Energy Economics Institute (KEEI); Beijing Energy Efficiency Centre; and Energy Policy and Planning Office, Ministry of Energy, Thailand.

companies raised prices again in August 2005. On the whole, iron and steel prices have increased by 5.5 per cent during the current financial year up to October 1, 2005 (Chart 28). All major metal producers in India also raised copper and zinc prices during the second quarter in line with international trends.



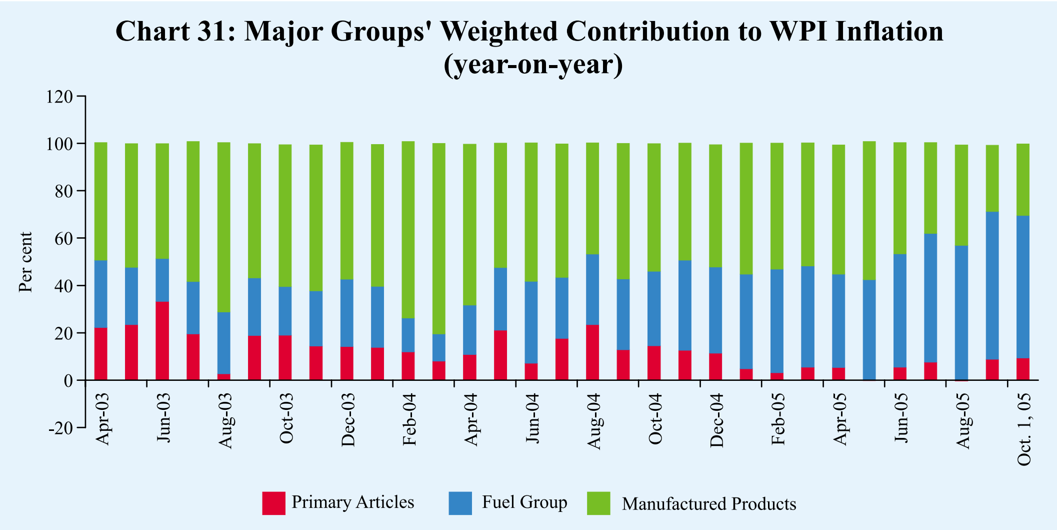
With the revival of the South-West monsoon, sowing picked-up sharply during July-August 2005 and *kharif* foodgrain production is expected to be higher than last year. This is likely to have a soothing effect on food prices in the second half of the current year. Higher sugarcane output is expected to contain sugar prices, which have so far remained high in line with international trends. Raw cotton prices - which increased marginally up to July 2005 reflecting worries about the monsoon - eased with the revival of the monsoon, in line with international trends (Chart 29).





Oilseed prices have hardened, *albeit* marginally, during the current financial year so far reflecting last year's shortfall in domestic production as well as expectations that production will be lower in the current season too. However, year-on-year, oilseeds inflation remains negative. Edible oil prices also declined in line with international trends (Chart 30).

In brief, domestic WPI inflation during 2005-06 so far has been dominated by mineral oil prices. As much as 60.1 per cent of the y-o-y WPI inflation as on October 1, 2005 is due to the fuel group followed by manufactured products (30.3 per cent) (Chart 31). Primary articles' contribution to the overall inflation has been lower so far despite the erratic monsoon.



Consumer Price Inflation

Consumer price inflation (measured by the CPI for Industrial Workers) during August 2005 was marginally lower than that during March 2005. Other measures of consumer price inflation, however, edged up reflecting higher food prices on account of the delayed onset and progress of the South-West monsoon (Table 29).

Table 29: Consumer Price Inflation (CPI) in India (year-on-year)

(Per cent)

Inflation Measure	March 2003	March 2004	August 2004	March 2005	June 2005	July 2005	August 2005
1	2	3	4	5	6	7	8
CPI-IW	4.1	3.5	4.6	4.2	3.3	4.1	3.4
CPI- UNME	3.8	3.4	4.0	4.0	3.9	4.8	4.3
CPI-AL	4.9	2.5	3.0	2.4	2.7	3.6	3.2
CPI-RL	4.8	2.5	3.0	2.4	2.7	3.8	3.2
Memo :							
WPI Inflation	6.5	4.6	8.7	5.1	4.3	4.2	3.0

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

Disaggregated information on CPI (Industrial Workers) available up to July 2005 shows firming up of food prices due to the erratic monsoon. On the other hand, increase in the housing index - which includes rent paid for rented, self-owned and rent free houses - in the CPI-IW basket decelerated from its March 2005 level (Table 30). Services inflation - proxied by the miscellaneous group in

Table 30: Consumer Price Inflation for Industrial Workers (year-on-year)

(Per cent)

Commodity	Weight	March 2005 Inflation	March 2005 WCs	July 2004 Inflation	July 2004 WCs	July 2005 Inflation	July 2005 WCs
1	2	3	4	5	6	7	8
CPI General Index	**100.0**	**4.2**	**100.0**	**3.2**	**100.0**	**4.1**	**100.0**
1. Food Group	**57.0**	**1.6**	**21.7**	**1.2**	**21.4**	**4.0**	**54.3**
i. Cereals and Products	20.5	0.7	2.9	-1.1	-6.4	2.0	8.8
ii. Pulses and Products	3.6	-2.0	-1.9	1.1	1.3	6.7	6.3
iii. Oils and Fats	5.0	-7.1	-6.9	-5.6	-7.2	-3.1	-2.9
iv. Meat, Fish and Eggs	4.3	5.0	6.3	5.9	9.4	5.8	7.6
v. Milk and Products	6.5	1.7	2.5	4.3	7.7	1.3	1.8
vi. Condiments and Spices	3.2	-9.0	-7.6	-3.6	-4.0	1.3	1.1
vii. Vegetables and Fruits	5.7	6.5	8.2	1.8	3.6	11.9	18.2
viii. Other Foods	8.3	7.8	17.7	5.9	17.1	6.1	14.2
2. Pan, Supari, Tobacco and Intoxicants	**3.2**	**2.1**	**2.1**	**2.8**	**3.5**	**2.2**	**2.3**
3. Fuel and Light	**6.3**	**4.9**	**8.7**	**8.4**	**18.4**	**-6.5**	**-11.7**
4. Housing	**8.7**	**20.4**	**50.0**	**11.7**	**36.8**	**11.7**	**31.4**
5. Clothing, Bedding and Footwear	**8.5**	**2.3**	**3.3**	**2.1**	**3.7**	**2.3**	**3.3**
6. Miscellaneous Group (Services)	**16.4**	**3.9**	**15.6**	**3.2**	**16.4**	**4.4**	**17.9**
i. Medical Care	2.6	4.4	3.2	5.8	5.3	2.7	2.0
ii. Education, Recreation and Amusement	3.1	5.1	3.4	4.1	3.5	6.6	4.5
iii. Transport and Communication	2.7	6.8	5.0	2.4	2.3	8.5	6.4
iv. Personal Care and Effects	3.3	3.2	2.5	3.5	3.5	3.0	2.4
v. Others	4.7	1.7	1.8	1.3	1.8	2.5	2.7

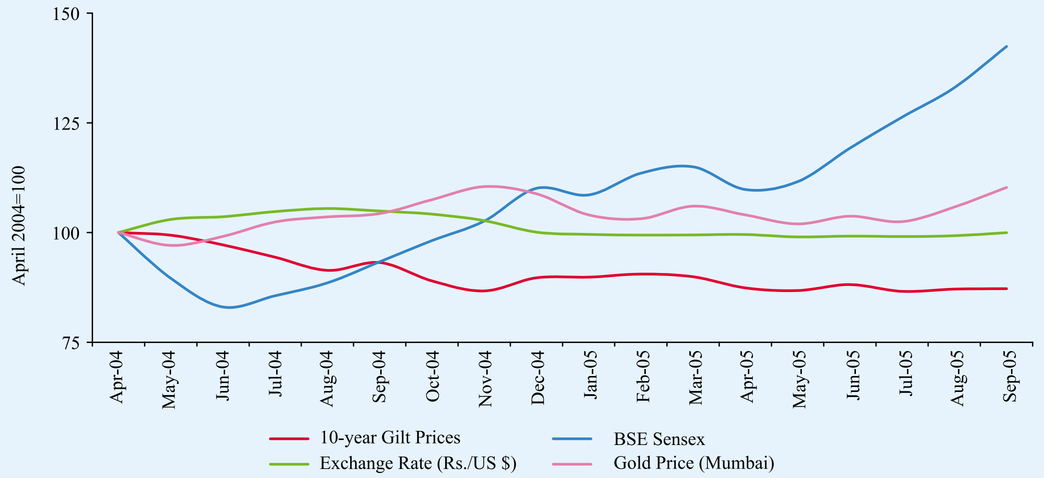
WCs : Weighted Contributions.

the CPI-IW - edged up marginally, reflecting increase in the prices of education and recreation, and transport and communication.

Asset Prices and Inflation

Equity markets reached successive record highs reflecting improved corporate performance, continued liquidity support by FIIs and recovery in monsoon (Chart 32). Corporate profitability remains strong and profits after tax increased by 54.2 per cent during April-June 2005. Gold prices remained firm in line with international trends on the back of sustained demand. Gilt prices have been largely range bound since May 2005 with intra-year movements influenced by trends in domestic inflation and liquidity conditions. The exchange rate of the rupee *vis-a-vis* the US dollar has generally remained stable during 2005-06 so far. During early October 2005, large current account deficit, slowdown in FII inflows and the strengthening of the US dollar *vis-a-vis* major currencies led to some downward pressure on the exchange rate.

Chart 32: Asset Price Movements



V. FINANCIAL MARKETS

Financial market conditions remained benign as long-term rates in major advanced economies were broadly unchanged and equity markets remained buoyant. Short-term interest rates, however, moved up in a number of economies with the firming up of inflationary pressures. Financing conditions in emerging markets also remained favourable reflecting improved economic fundamentals, the increased presence of long-term investors and continued search for yields. At the same time the current benign environment of low long-term rates and flat yield curves is believed to have contributed to larger global imbalances and higher levels of debt, particularly by the household sector, thus, increasing potential vulnerabilities.

Short-term interest rates rose further during the second quarter across a number of countries, especially emerging economies. The US Federal Reserve raised Federal Funds target rate by 25 basis points for the 11th consecutive time to 3.75 per cent on September 20, 2005. In a few countries such as the UK and Sweden, short-term interest rates softened further during the second quarter in the face of a weakening of economic activity (Table 31).

In contrast to the behaviour of short-term rates, long-term government bond yields in the US have been almost unchanged since end-March 2005 leading to a flattening of the yield curve. Yields had initially declined during April-June

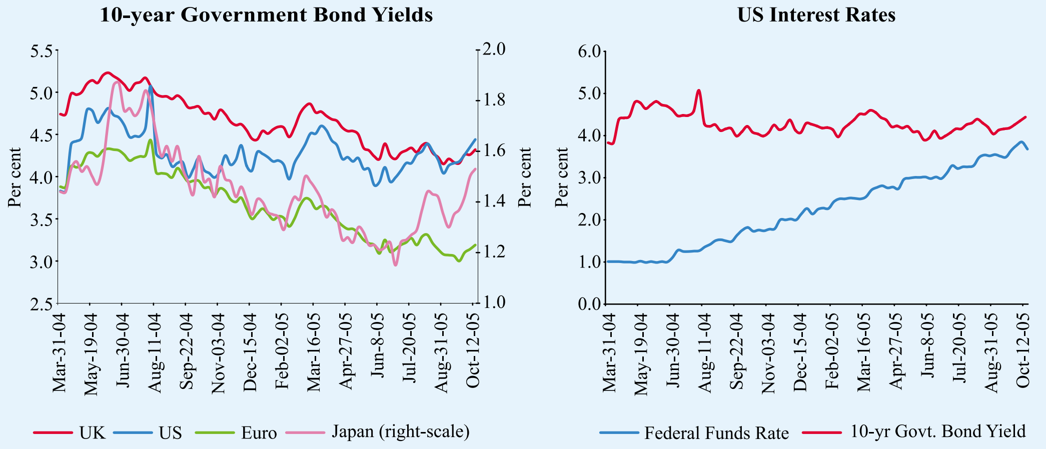
Table 31: Short-term Interest Rates

(Per cent)

Country	March 2004	March 2005	June 2005	September 2005
1	2	3	4	5
Advanced Economies				
Euro Area	1.96	2.15	2.10	2.15
Japan	0.03	0.02	0.02	0.02
Sweden	2.12	1.97	1.48	1.46
UK	4.31	4.95	4.75	4.56
US	1.04	2.90	3.33	3.85
Emerging Market Economies				
Argentina	2.88	4.56	6.94	6.69
Brazil	16.02	19.25	19.74	19.51
China	n.a.	2.25	2.30	4.38
Hong Kong	0.17	2.79	3.36	4.12
India	**4.24**	**5.37**	**5.37**	**5.49**
Malaysia	3.00	2.82	2.87	2.92
Philippines	9.19	7.25	5.88	8.13
Singapore	0.69	2.06	2.06	2.34
South Korea	3.90	3.54	3.52	3.94
Thailand	1.31	2.64	2.75	3.90

n.a. : Not available.
Note: Data for India refer to 91-day Treasury Bills rate and for other countries 3-month money market rates.
Source: The Economist.

Chart 33: Interest Rates – Advanced Economies



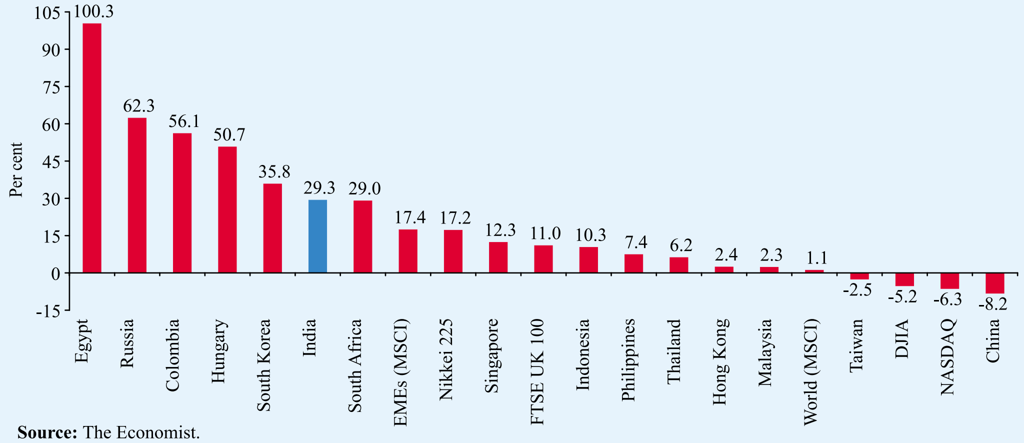
2005 on expectations that monetary authorities could slow down policy tightening due to fragility in the economic recovery (Chart 33). Structural factors such as increased demand for fixed income products from pension funds and insurance companies in response to regulatory changes also provided support to long-term gilts. In the US, the 10-year Treasury yield at 3.8 per cent was at a 14-month low in early-June 2005. Japanese and Euro area bond yields also dropped to record lows in June 2005. Similarly, yield curves in Australia, New Zealand and the UK flattened or inverted. During July 2005, yields, however, firmed up in the run up to the widely anticipated revaluation of the Chinese currency on July 21, 2005. Yields edged up on the expectation that the revaluation will moderate foreign exchange reserves accretion of China and other Asian central banks which, in turn, might reduce demand for US dollar assets by these central banks. With the Chinese authorities continuing to manage the renminbi tightly, the yields, however, reversed their increasing trend. More recently, yields in the US have again firmed up on signs of strong growth and upward revisions to the expected path of policy rates.

Equity markets exhibited resilience against higher oil prices and witnessed rallies reflecting strong corporate profitability. During the calendar year 2005 so far (up to October 12, 2005), stock markets in India have outperformed all major Asian markets excepting South Korea (Chart 34). Stock markets in some emerging economies outside Asia yielded even higher returns led by Egypt (100.3 per cent since end-December 2004), followed by Russia, Colombia and Hungary.

The US dollar has appreciated against major currencies during 2005-06 so far, reflecting growing interest and growth differential in favour of the US and uncertainty relating to growth prospects in the Euro area (Chart 35). The US dollar, however, slid during July-August 2005 as the market's focus returned to structural concerns, namely the twin budget and external deficits in the US. The

Chart 34: International Stock Markets

(Percentage Change between December 31, 2004 and October 12, 2005)



Source: The Economist.

long anticipated revaluation of the Chinese renminbi on July 21, 2005 was received calmly, with little lasting impact in the financial markets. The renminbi has appreciated little since the July revaluation.

Indian financial markets have remained broadly stable during 2005-06 so far. Comfortable liquidity kept money market segments generally around the reverse repo rate. The foreign exchange market remained more or less orderly. Yields in the Government securities market which had hardened in April 2005 reflecting higher crude oil prices and increase in the reverse repo rate have since been range bound. In the credit market, key interest rates edged up as commercial credit offtake continued to remain strong and broad-based. The primary market

Chart 35: Exchange Rate of Major Currencies per US dollar

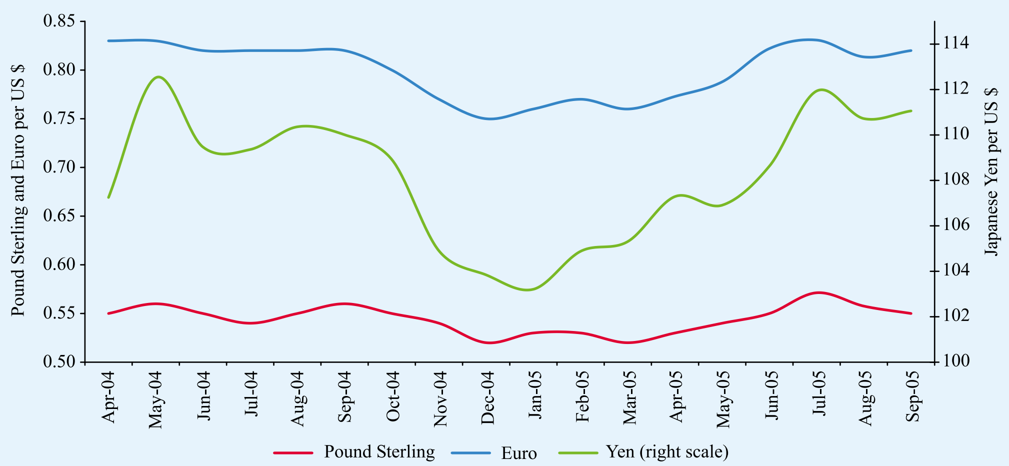


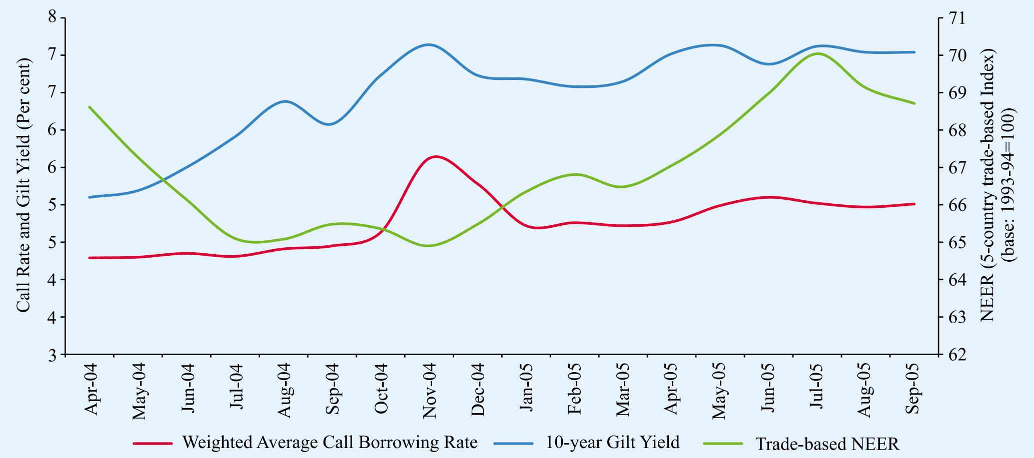
Table 32: Domestic Financial Markets at a Glance

Month	Call Money: Average Daily Turnover (Rs. crore)	Call Money: Average Call Rates* (Per cent)	Govt. Securities: Average 10-Year Yield@ (Per cent)	Govt. Securities: Average Daily Turnover (Rs. crore)+	Foreign Exchange: Average Daily Inter-bank Turnover (US $ million)	Foreign Exchange: Average Exchange Rate (Rs.per US $)	Foreign Exchange: RBI's net Foreign Currency Sales(-)/ Purchases (+) (US $ million)	Foreign Exchange: Average Forward Premia 3-month (Per cent)	Liquidity Management: Average MSS Outstanding # (Rs. crore)	Liquidity Management: Average Daily Reverse Repo (LAF) Outstanding (Rs. crore)	Equity: Average Daily BSE Turnover (Rs. crore)	Equity: Average Daily NSE Turnover (Rs. crore)	Equity: Average BSE Sensex**	Equity: Average S&P CNX Nifty**
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
2004-05														
April	12,916	4.29	5.10	10,029	10,302	43.93	7,427	- 0.35	14,296	75,006	2,243	5,048	5809	1848
May	10,987	4.30	5.19	6,202	8,882	45.25	-220	-1.33	27,518	74,502	2,188	4,710	5205	1640
June	10,973	4.35	5.50	5,860	7,847	45.51	-413	0.93	35,183	61,981	1,681	3,859	4824	1506
July	8,632	4.31	5.91	4,206	7,756	46.04	-1,180	2.25	43,739	59,594	1,793	4,265	4973	1568
August	11,562	4.41	6.38	4,173	5,947	46.34	-876	2.85	48,541	42,692	1,736	3,948	5144	1615
September	17,088	4.45	6.08	5,854	7,348	46.09	19	2.20	52,421	31,589	1,800	4,023	5423	1692
October	16,667	4.63	6.73	3,636	7,262	45.78	-99	2.87	53,660	10,805	1,730	3,785	5702	1795
November	13,820	5.62	7.14	2,607	9,930	45.13	3,792	2.20	54,157	-5,066	1,787	4,102	5961	1874
December	19,527	5.28	6.73	4,305	9,447	43.98	1,393	2.02	52,085	7,570	2,184	5,026	6394	2022
January	16,534	4.72	6.68	3,566	9,114	43.75	0	2.50	53,790	18,721	2,310	5,249	6307	1978
February	16,041	4.76	6.58	4,640	11,583	43.68	4,974	1.99	58,141	19,895	2,484	4,999	6595	2067
March	15,293	4.72	6.65	2,835	11,286	43.69	6,030	1.82	63,737	29,809	2,706	5,139	6679	2096
2005-06														
April	17,213	4.77	7.02	3,001	9,880	43.74	0	1.96	65,638	30,675	1,890	4,136	6379	1987
May	15,269	4.99	7.13	3,805	10,083	43.49	0	1.57	68,539	22,754	1,971	3,946	6483	2002
June	20,135	5.10	6.88	6,807	10,871	43.58	-104	1.40	70,651	13,916	2,543	4,843	6926	2134
July	20,046	5.02	7.12	3,698	10,812 P	43.54	2,473	1.56	70,758	10,754	3,095	6,150	7337	2237
August	16,158	5.02	7.04	4,239	11,462 P	43.62	1,552	0.69	71,346	34,832	3,452	6,624	7726	2358
September	16,292	5.05	7.04	5,207	9,750 P	43.92	n.a.	0.62	67,617	31,570	3,871	6,923	8272	2512

* : Average of daily weighted call money borrowing rates.
@ : Average of daily closing rates.
MSS : Market Stabilisation Scheme.
\# : Average of weekly outstanding MSS.
\+ : Average of daily outright turnover in Central Government dated securities.
** : Average of daily closing indices.
BSE : The Stock Exchange, Mumbai.
n.a : Not available.
LAF : Liquidity Adjustment Facility.
NSE : National Stock Exchange of India Ltd.
P : Provisional.

segment of the equity market gathered momentum with increase in both the number of issues and the resources raised on the back of a buoyant secondary market and strong macroeconomic fundamentals. The secondary market staged a strong rally which pushed the BSE Sensex to new highs touching 8800 mark in early-October 2005 (Table 32 and Chart 36).

Chart 36: Call Rate, Gilt Yield and Exchange Rate

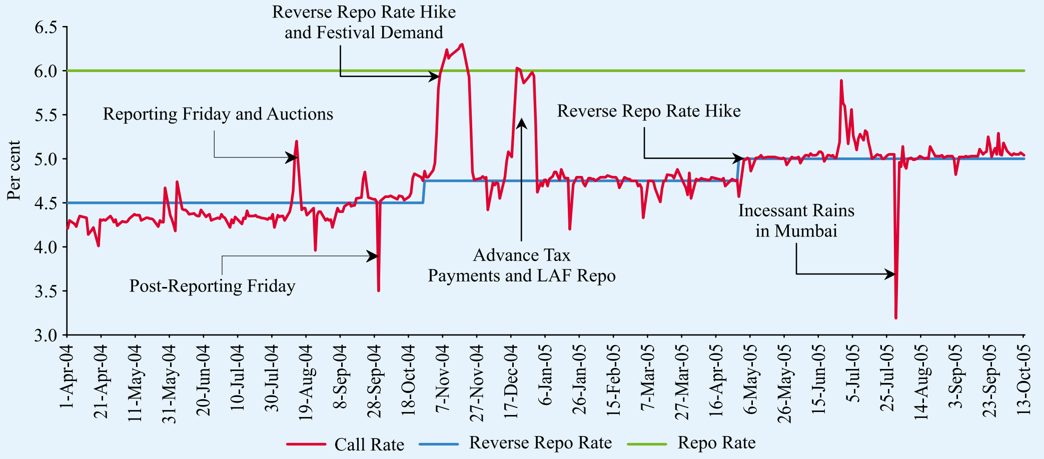


Money Market

Money markets during 2005-06 so far have been marked by comfortable liquidity conditions stemming from the overhang in the system – outstanding Liquidity Adjustment Facility (LAF) and Market Stabilisation Scheme (MSS) balances at end-March 2005 stood at Rs.83,541 crore. Despite FII outflows in April 2005, the Reserve Bank had to supplement reverse repo operations with sale of Government paper under the MSS to absorb liquidity and balance market conditions. Average daily call money borrowing rates ruled at sub-reverse repo rate levels on many occasions. With the increase in the fixed reverse repo rate by 25 basis points on April 29, 2005, call rates also edged up by a similar magnitude. Towards the end of June 2005, call rates rose above the reverse repo rate under liquidity pressures – average balances under LAF reverse repos fell from Rs.22,754 crore during May 2005 to Rs.13,916 crore during June 2005 – emanating from advance tax payments and scheduled Treasury Bills auctions. The Reserve Bank injected Rs.210 crore and Rs.575 crore under the LAF repo on June 28, 2005 and June 30, 2005, respectively, to assuage the demand pressures. On a net basis, however, there was liquidity absorption on these days.

Liquidity conditions improved by the second half of July 2005 due to cancellation of some scheduled Treasury Bills auctions and return of advance tax payments to the banking system. Large foreign currency purchases from the authorised dealers during July-August 2005 also improved liquidity conditions and this was reflected in a jump in average balances under LAF reverse repos from Rs.10,754 crore in July to Rs.34,832 crore in August 2005. The call money market, thus, remained broadly stable during August 2005 and the first half of September 2005. During the second half of September 2005 the call money market witnessed mild pressure, reflecting advance tax outflows and scheduled auctions. The Reserve Bank injected Rs.1,640 crore and Rs.1,000 crore under the LAF repo on September 28, 2005 and September 29, 2005, respectively. On a net basis, however, there was liquidity absorption on these days. The call money rate was 5.06 per cent as on October 19, 2005 (Chart 37).

Chart 37: Call Rate and the Reverse Repo Rate



The turnover in the call/notice money market during 2005-06 so far has been range bound reflecting the process of phasing out of non-bank participants from the call money market, which was completed on August 6, 2005 (Table 33). Turnover increased during June-July due to higher activity reflecting some liquidity pressures. The emergence of alternative avenues of deployment of funds such as the market repo (other than with the Reserve Bank) and the Collateralised Borrowing and Lending Obligation (CBLO) segments which provide funds at a lower cost also explain the relative decline in call money market turnover (Chart 38). The supply of funds in the CBLO segment has been augmented by the participation of mutual funds and financial institutions. Members operating in the CBLO segment of the Clearing Corporation of India Limited (CCIL) have increased from 110 in March 2005 to 125 in early-October 2005.

Other Money Market Instruments

The commercial paper (CP) market remained buoyant with outstanding CPs increasing from Rs.14,235 crore at end-March 2005 to Rs.19,725 crore by September 30, 2005. Leasing and finance companies continue to be the largest

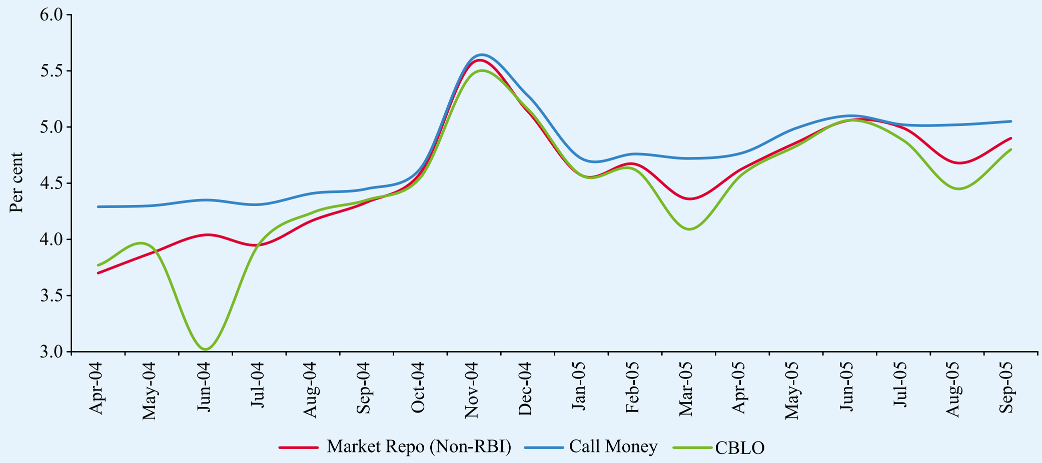
Table 33: Activity in Money Market Segments

(Rupees crore)

Month	Average Daily Turnover				Outstanding Amount		Forward Rate Agreements/ Interest Rate Swaps (Notional Amount)
	Call Money Market	Term Money Market	Repo Market (Outside the LAF)	Collateralised Borrowing and Lending Obligation (CBLO)	Commercial Paper	Certificates of Deposit	
1	2	3	4	5	6	7	8
2004-05							
April	12,916	325	15,195	2,496	10,362	4,725	5,76,808
May	10,987	372	15,932	3,872	11,038	4,860	6,11,595
June	10,973	274	17,517	4,015	10,950	5,438	6,04,669
July	8,632	445	19,226	4,508	11,038	5,478	5,90,118
August	11,562	311	13,561	4,962	11,002	4,480	6,40,173
September	17,088	487	18,178	6,149	11,371	5,112	8,53,191
October	16,667	539	15,719	8,466	10,409	4,785	9,25,175
November	13,820	407	18,560	9,651	10,719	6,118	9,50,151
December	19,527	504	21,922	9,962	13,272	6,103	9,75,135
January	16,534	514	17,556	7,701	13,092	4,237	10,14,442
February	16,041	878	17,562	8,952	13,189	9,214	9,46,293
March	15,293	1,253	14,688	9,625	14,235	12,078	10,62,242
2005-06							
April	17,213	661	12,174	10,369	15,598	16,602	10,76,513
May	15,269	545	13,688	12,233	17,182	17,689	10,72,684
June	20,135	534	17,163	12,075	17,797	19,270	10,93,367
July	20,046	717	18,103	15,291	18,607	20,768	12,18,072
August	16,158	754	21,325	14,544	19,508	23,568	13,15,084
September	16,292	1,116	18,872	17,143	19,725	25,604*	13,15,306

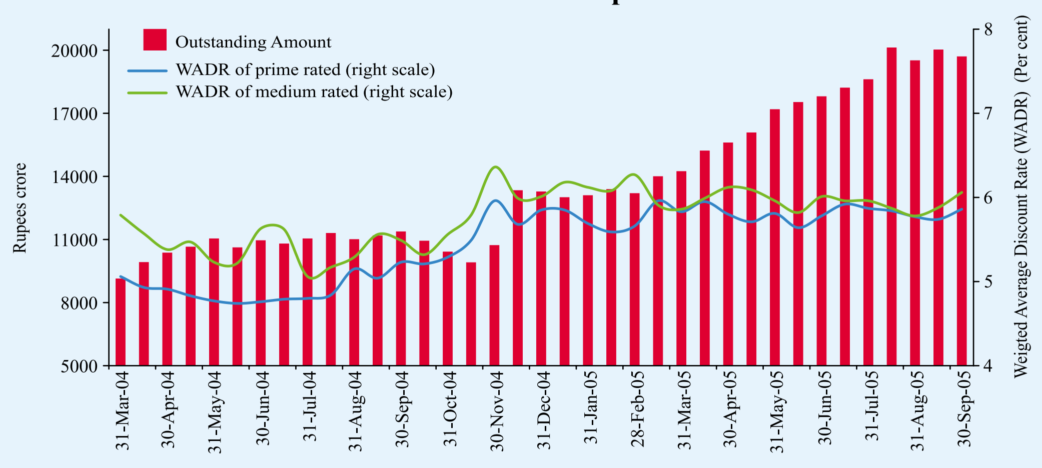
* : As on September 16, 2005.

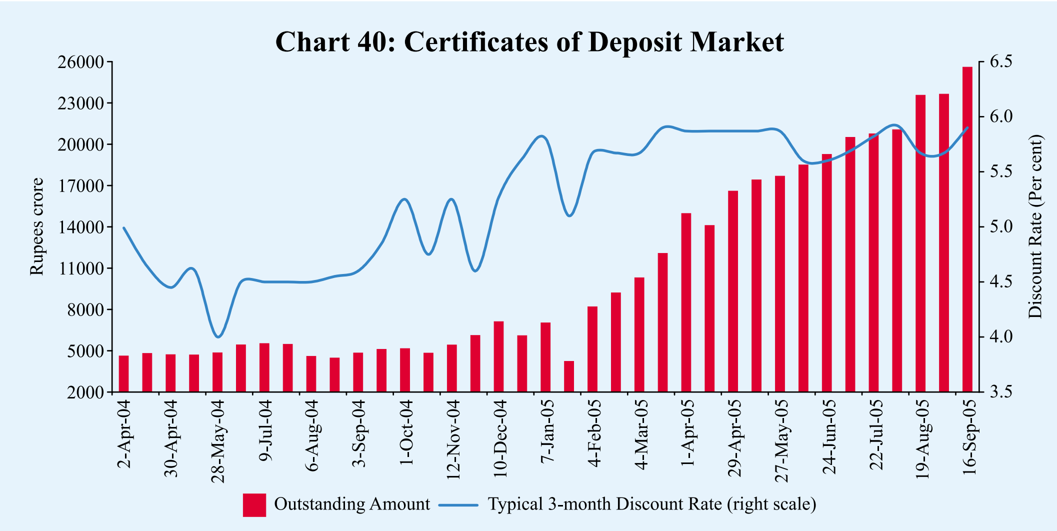
Chart 38: Interest Rates in Money Markets



issuers of CPs, partly reflecting the phasing out of these companies from accessing public deposits. The share of these companies in the total CP outstanding increased from 59.6 per cent at end-March 2005 to 65.6 per cent by September 30, 2005. Manufacturing and other companies and financial institutions are the other issuers with shares of 19.1 per cent and 15.3 per cent, respectively, as on September 30, 2005. Despite a pick-up in issuances, the weighted average discount rate (WADR) on CPs at 5.87 per cent on September 30, 2005 was almost the same as at end-March 2005 (5.84 per cent), reflecting strong investment interest by mutual funds in an environment of comfortable liquidity (Chart 39).

Chart 39: Commercial Paper Market





The market for certificates of deposit (CDs) has also remained buoyant during the year so far, reflecting their cost attractiveness to banks *vis-à-vis* time deposits as well as banks' demand for funds in the wake of the acceleration in demand for bank credit. The outstanding CDs increased from Rs.14,975 crore in early-April 2005 to Rs.25,604 crore by September 16, 2005 mainly on account of higher issuances by some private sector banks. The higher recourse to CDs was also driven by the reduction in the minimum maturity period to seven days. Outstanding CDs were 5.4 per cent of aggregate deposits of issuing banks as on September 16, 2005, up from 1.6 per cent a year ago, indicating the growing importance of CDs as a source of funds for the issuing banks. The typical three-month discount rate on CDs at 5.90 per cent on September 16, 2005 was exactly the same as at end-March 2005 (Chart 40). As in the case of CPs, mutual funds have emerged as key investors in CDs.

Amongst other money market segments, the market for forward rate agreements and interest rate swaps (FRAs/IRS) continued to expand with the participation of select public sector banks, primary dealers (PDs) and foreign and private sector banks (see Table 33). In most of these contracts, the NSE-Mumbai Inter-Bank Offered Rate (MIBOR), Mumbai Inter-Bank Forward Offered Rate (MIFOR), secondary market yields of the Government of India securities with a residual maturity of one year and the primary cut-off yield on 364-day Treasury Bills were used as the benchmark rates.

Treasury Bills

Reflecting comfortable liquidity conditions and easing of headline inflation, yields in Treasury Bills (TBs) auctions have been broadly unchanged since March 2005. Yields had edged up marginally during July 2005 reflecting some liquidity tightness. With improvement in liquidity conditions and further softening of headline inflation, bidding interest revived and average yields declined by 18-

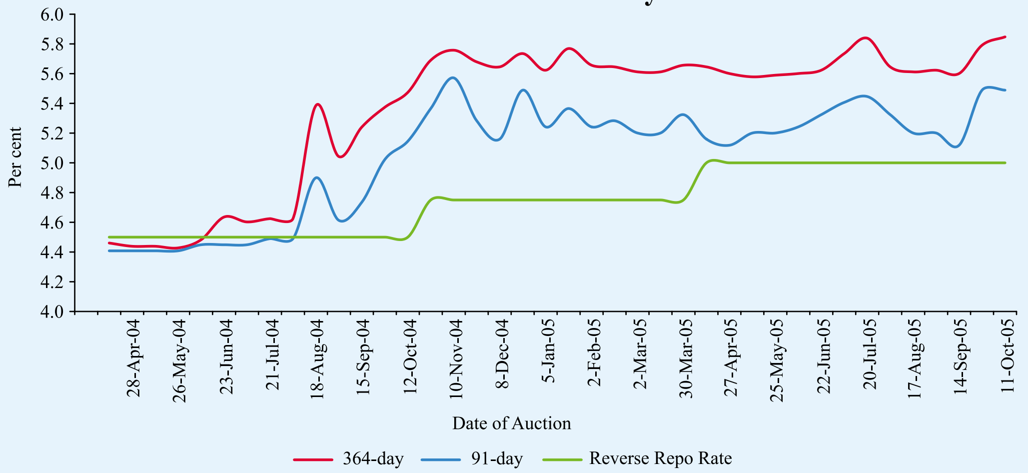
Table 34: Treasury Bills in the Primary Market

Month	Average Implicit Yield at Minimum Cut-off Price (Per cent)			Bid-Cover Ratio		
	91-day	182-day	364-day	91-day	182-day	364-day
1	2	3	4	5	6	7
2004-05						
April	4.38		4.44	2.15		2.47
May	4.39		4.33	2.93		2.46
June	4.44		4.55	2.61		1.28
July	4.46		4.60	2.39		2.06
August	4.76		5.00	1.81		3.36
September	4.72		5.14	2.51		2.83
October	5.15		5.46	1.82		2.75
November	5.47		5.71	2.80		2.64
December	5.30		5.69	2.69		2.81
January	5.31		5.69	2.19		2.06
February	5.25		5.65	2.99		2.81
March	5.24		5.63	2.31		2.74
2005-06						
April	5.17	5.36	5.62	4.03	4.48	2.54
May	5.19	5.35	5.58	3.30	3.37	2.29
June	5.29	5.37	5.61	1.54	2.42	1.81
July	5.46	5.67	5.81	1.21	2.58	1.68
August	5.23	5.42	5.63	3.07	2.68	2.54
September	5.24	5.37	5.70	1.52	1.45	1.61

Note: 182-day TBs were reintroduced with effect from April 2005.

25 basis points across the various TBs during August 2005, close to their March 2005 levels. Yields edged up marginally in the last week of September reflecting some liquidity tightness. The yield spread between the 91-day and 364-day TBs at 46 basis points during September 2005 was marginally higher than the March 2005 level (39 basis points) (Table 34 and Chart 41).

Chart 41: Yields of Treasury Bills

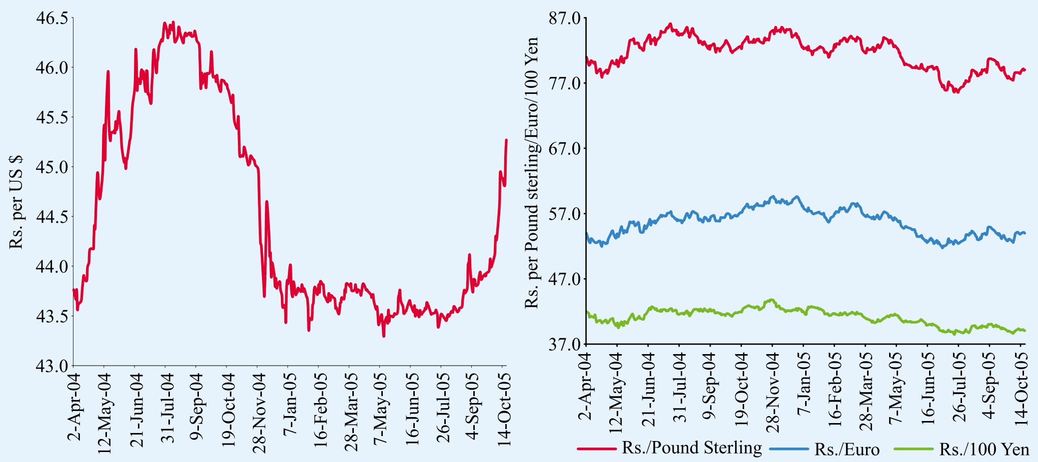


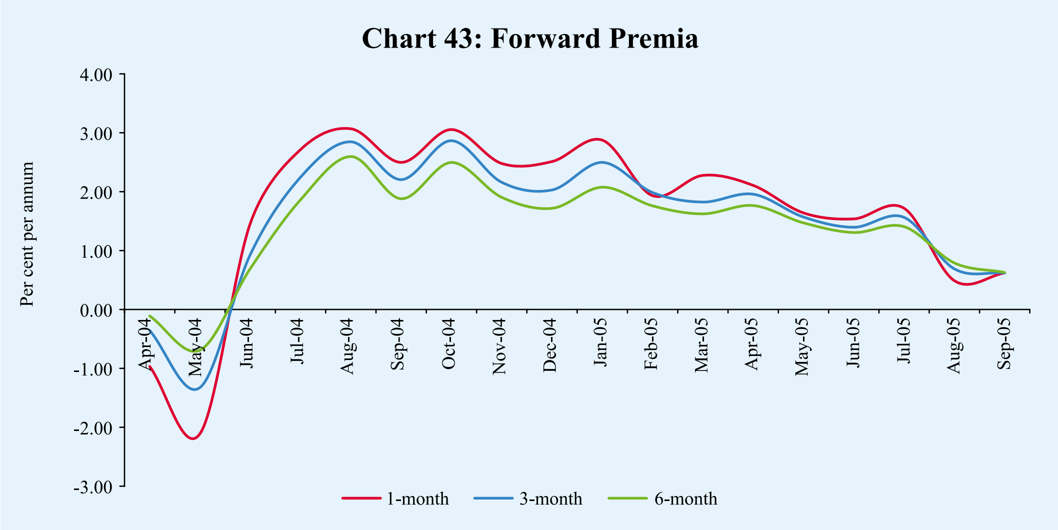
Foreign Exchange Market

In the foreign exchange market, the Indian rupee has moved in a range of Rs.43.30–45.27 per US dollar during 2005-06 so far (up to October 19, 2005). Despite outflows by FIIs and a higher merchandise trade deficit, the rupee initially appreciated against the US dollar from Rs.43.76 at end-March 2005 to Rs.43.30 per US dollar on May 12, 2005. Subsequently, the rupee depreciated, reaching Rs.43.76 per US dollar on June 2, 2005 due to strengthening of the US dollar in the international markets. With the revaluation of the Chinese yuan on July 21, 2005, there were appreciation pressures and the rupee stood at Rs.43.56 per US dollar on August 18, 2005. The Reserve Bank made net market purchases of US $ 4.0 billion during July-August 2005. The rupee again came under pressure in the last week of August 2005 and reached Rs.44.12 per US dollar on September 1, 2005, under the impact of oil prices touching a peak of US $ 70.8 per barrel in the international market as Hurricane Katrina disrupted oil and gas production in Gulf of Mexico region in the US. Subsequently, the rupee recovered marginally and stood at Rs.44.08 on September 28, 2005. The rupee came under pressure in the first week of October 2005 in the face of sharp increase in the current account deficit, FII outflows and the strengthening of the US dollar in the international markets. The exchange rate stood at Rs.45.27 per US dollar on October 19, 2005. At this level, the Indian rupee has depreciated by 3.3 per cent over its level on March 31, 2005. Reflecting cross-currency movements, the rupee has, however, appreciated against the other major international currencies since end-March 2005: the Euro (4.8 per cent), the Pound sterling (3.9 per cent) and the Japanese yen (4.5 per cent) (Chart 42).

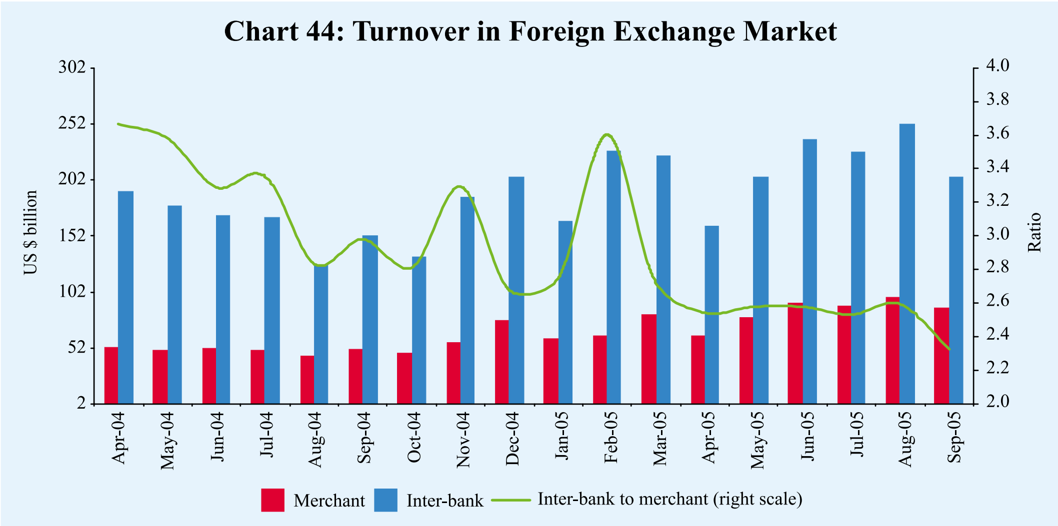
Forward premia continued to decline in tandem with narrowing interest differential following the further hikes in the US interest rates (Chart 43).

Chart 42: Rupee *vis-a-vis* Major Currencies





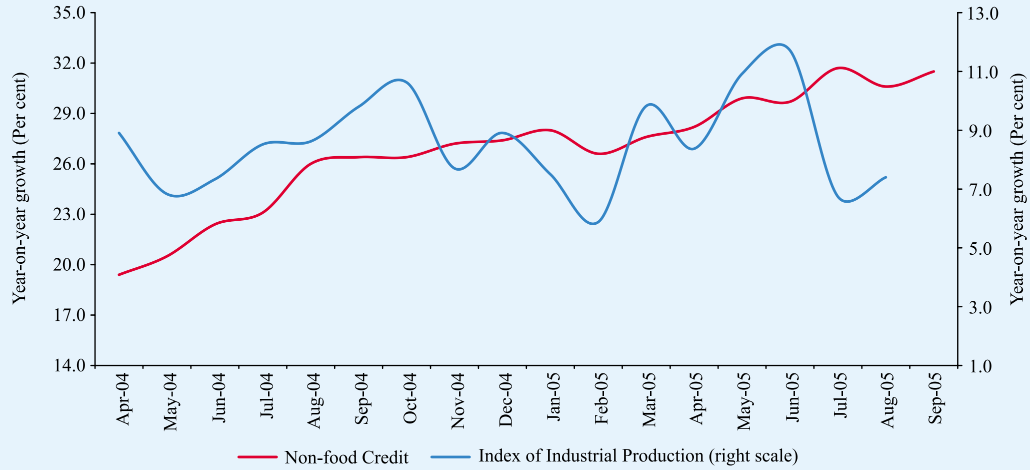
The turnover in the foreign exchange market (both merchant and inter-bank), which had dropped sharply to US $ 223.6 billion in April 2005 (US $ 305.7 billion in March 2005), recovered in the subsequent months to reach US $ 349.3 billion in August 2005. It fell again to US $ 292.8 billion in September 2005 (Chart 44).



Credit Market

The demand for credit from the commercial sector has strengthened further during 2005-06 so far (Chart 45). As on September 30, 2005, the year-on-year non-food credit extended by scheduled commercial banks grew by 31.5 per cent (net of conversion) on top of 24.9 per cent growth a year ago. Food credit recorded a marginal fall over its end-March 2005 level on account of lower procurement.

Chart 45: Non-food Credit and Industrial Production



Demand for bank credit has been broad-based led by agriculture, industry and housing sectors (Table 35). The increase in industrial credit was mainly on account of infrastructure (*viz.*, power, roads, ports and telecommunications), iron

Table 35: Deployment of Non-food Bank Credit

(Rupees crore)

Sector/Industry	Outstanding as on August 19, 2005	Year-on-year Variations			
		August 20, 2004		August 19, 2005	
		Absolute	Per cent	Absolute	Per cent
1	2	3	4	5	6
1. Priority sector #	**3,81,991**	**56,744**	**25.9**	**1,05,945**	**38.4**
Agriculture	1,27,621	19,624	26.4	33,626	35.8
Small Scale	73,568	4,610	7.9	10,331	16.3
Others	1,80,802	32,510	37.7	61,988	52.2
2. Industry (Medium and Large)	**3,18,578**	**40,940**	**18.6**	**57,857**	**22.2**
3. Wholesale Trade	**29,258**	**3,863**	**17.5**	**3,360**	**13.0**
4. Other Sectors	**2,70,418**	**49,969**	**31.1**	**59,728**	**28.3**
Housing	97,349	22,074	54.6	34,866	55.8
Consumer Durables	7,545	-167	-2.1	-179	-2.3
Non-Banking Financial Companies	19,482	975	6.4	3,349	20.8
Real Estate Loans	16,564	1,272	24.9	10,185	159.7
Advances against Fixed Deposits	25,803	3,034	14.1	1,321	5.4
5. Non-food Gross Bank Credit (1 to 4)	**10,00,245**	**1,51,516**	**24.4**	**2,26,890**	**29.3**
Memo:					
Industry (Medium, Large and Small)	**3,92,146**	**45,550**	**16.4**	**68,188**	**21.0**
Petroleum	16,277	5,520	57.4	1,143	7.6
Infrastructure	82,444	17,382	64.7	22,778	38.2
Iron and Steel	33,148	381	1.5	6,753	25.6
Other Metal & Metal Products	10,915	1,055	13.6	2,077	23.5
Construction	9,412	1,684	31.3	2,352	33.3
Paper & Paper Products	6,778	626	12.1	979	16.9
Gems & Jewellery	13,448	1,746	21.1	3,418	34.1
Rubber & Rubber Products	4,146	355	14.1	1,280	44.7
Cotton Textiles	21,529	2,362	15.9	4,285	24.8
Other Textiles	18,731	1,594	11.2	2,927	18.5
Automobiles	9,786	441	8.4	4,070	71.2
Cement	6,811	-219	-3.7	1,051	18.2
Food Processing	10,299	1,197	14.8	987	10.6

: Excluding investment 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.

and steel, cotton textiles, automobiles, and gems and jewellery. On a year-on-year basis, credit to agriculture recorded a robust growth of 35.8 per cent on top of 26.4 per cent growth a year ago reflecting various policy initiatives to improve the flow of credit to the sector. Credit to the housing sector continued to be strong benefiting from low interest rates and tax incentives. Credit to the commercial real estate sector increased sharply.

During the second quarter, foreign banks increased their deposit rates by about 25 basis points for shorter tenor, while public sector banks (PSBs) reduced their deposit rates for shorter tenor (Table 36). Lending rates of all banks hardened marginally in June 2005, though benchmark prime lending rates (BPLR) have remained unchanged since end-March 2005.

Table 36: Movements in Deposit and Lending Rates

(Per cent)

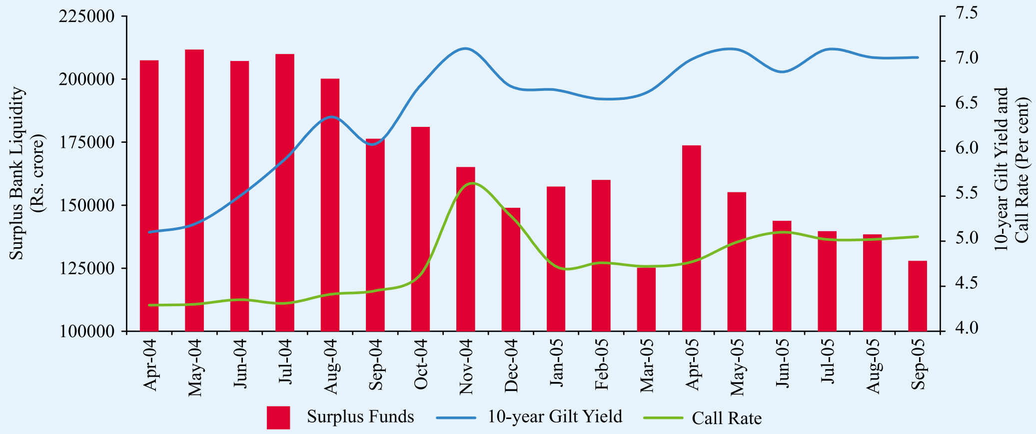
Interest Rate	March 2004	March 2005	June 2005	September 2005
1	2	3	4	5
1. Domestic Deposit Rate				
Public Sector Banks				
Up to 1 year	3.75-5.25	2.75-6.00	2.75-6.00	2.00-6.00
More than 1 year and up to 3 years	5.00-5.75	4.75-6.50	5.25-6.25	5.25-6.25
More than 3 years	5.25-6.00	5.25-7.00	5.50-6.50	5.50-6.50
Private Sector Banks				
Up to 1 year	3.00-6.00	3.00-6.25	3.00-6.25	3.00-6.25
More than 1 year and up to 3 years	5.00-6.50	5.25-7.25	5.00-7.00	5.00-7.00
More than 3 years	5.25-7.00	5.75-7.00	5.50-7.25	5.75-7.00
Foreign Banks				
Up to 1 year	2.75-7.75	3.00-6.25	3.00-5.50	3.00-5.75
More than 1 year and up to 3 years	3.25-8.00	3.50-6.50	3.50-6.50	3.50-6.50
More than 3 years	3.25.800	3.50-7.00	4.00-7.00	4.00-7.00
2. Benchmark Prime Lending Rate				
Public Sector Banks	10.25-11.50	10.25-11.25	10.25-11.25	10.25-11.25
Private Sector Banks	10.50-13.00	11.00-13.50	11.00-13.50	11.00-13.50
Foreign Banks	11.00-14.85	10.00-14.50	10.00-14.50	10.00-14.50
3. Actual Lending Rate*				
Public Sector Banks	4.00-16.00	2.75-16.00	3.35-16.50	n.a.
Private Sector Banks	4.50-22.00	3.15-22.00	3.15-24.94	n.a.
Foreign Banks	3.75-23.00	3.55-23.50	4.00-25.00	n.a.

n.a. : Not available.
* : Interest rate on non-export demand and term loans above Rs.2 lakh excluding lending rates at the extreme five per cent on both sides.

Government Securities Market

Yields in the Government securities market since May 2005 have largely been range-bound with intra-year movements influenced by domestic liquidity conditions, inflationary expectations and volatility in crude oil prices. Yields edged up from the second week of April 2005 reflecting concerns arising from the persistent rise in international crude oil prices, higher than expected inflation and the hike in the reverse repo rate. The 10-year benchmark yield firmed up to 7.31 per cent on April 30, 2005 from 6.65 per cent on March 31, 2005. With the easing of headline WPI inflation, yields softened during May 2005 touching 6.94 per cent on June 1, 2005. The yields edged up again during the first half of July 2005 reaching 7.23 per cent on July 13, reflecting higher crude oil prices, liquidity concerns and anticipation of

Chart 46: Surplus Bank Liquidity and Interest Rates

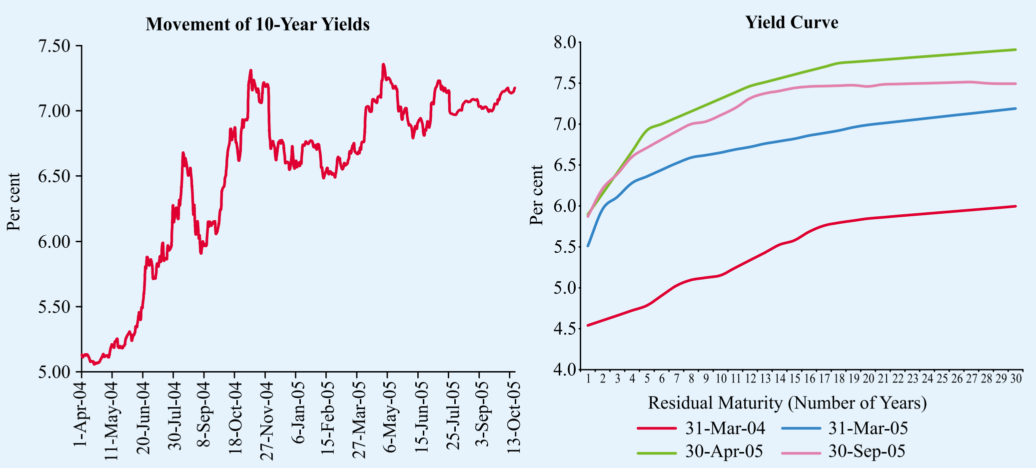


Surplus Fund: Surplus of net demand and time liabilities in excess of statutory pre-emptions and credit off-take.

an increase in the reverse repo rate. Contraction in surplus bank liquidity also reduced the market appetite for the Government paper (Chart 46).

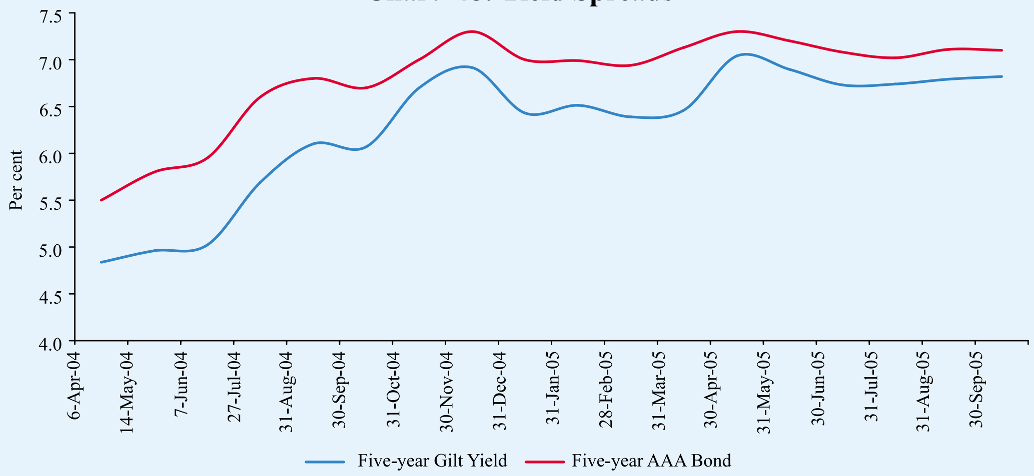
With the reverse repo rate being left unchanged on July 26, 2005 in the First Quarter Review of the Annual Statement on Monetary Policy and comfortable liquidity conditions, yields softened, reaching 6.98 per cent on July 29. Since then, the yields have remained broadly stable hovering at around seven per cent. The 10-year yield stood at 7.18 per cent on October 19, 2005, 53 basis points higher than its end-March 2005 level. The spread between 1-year and 10-year yields increased to 124 basis points at end-September 2005 (from 114 basis points at end-March). The spread between 10-year and 30-year yields, however, declined to 38 basis points (from 54 basis points at end-March) (Chart 47).

Chart 47: Yields on Central Government Securities



The yield on 5-year AAA-rated corporate bonds remained broadly at its end-March level and the yield spread over 5-year Government securities, thus, declined to 28 basis points at end-September 2005 from 67 basis points at end-March 2005 (Chart 48).

Chart 48: Yield Spreads



Equity Market

Capital markets exhibited buoyancy during the first half of 2005-06. Equity issues by corporates through initial public offerings and the privately placed debt issuances by the private sector companies witnessed substantial increase. Tapping of international markets by the Indian corporates also witnessed an encouraging trend. Both the BSE Sensex and S&P CNX Nifty touched historic high levels during June-October 2005. Satisfactory progress of the monsoon, robust industrial growth, satisfactory corporate results, strong investments by foreign institutional investors (FIIs) and mutual funds, and firm trends in international markets enthused the market sentiment.

Primary Market

The public issues segment continued to exhibit buoyancy during April-September 2005 in line with the trends witnessed in 2004-05. Both the numbers of public issues and amounts mobilised increased sharply (Table 37). The average size of public issues at Rs.193 crore in April-September 2005 was much lower than the average size of Rs. 388 crore in the corresponding period of the previous year. The bulk of the resources was raised by way of equity issues. Non-Government public limited companies (private sector) accounted for 63.4 per cent of resources mobilised by way of public issues. Three public sector banks raised equity worth Rs.2,520 crore. Out of 55 issues during April-September 2005, 26 issues were initial public offerings (IPOs), constituting 63.1 per cent of resource mobilisation as compared with nine out of 25 issues being IPOs during

April-September 2004 (constituting 26.7 per cent of resource mobilisation). All the IPOs in the current financial year so far have been by companies in the private sector except one from a public sector financial company.

Mobilisation of resources through private placement recorded an increase of 75.4 per cent during the first quarter of 2005-06 (Table 37). Private sector entities continued to dominate the private placement market with a share of 61.0 per cent in total mobilisation during April-June 2005. Financial intermediaries (both from public and private sectors) accounted for 56.4 per cent of the total mobilisation under the private placements during April-June 2005.

Apart from domestic capital markets, the Indian corporates also accessed international markets and the resources raised through Euro issues increased by 180.0 per cent to Rs.3,828 crore during April-September 2005.

Gross mobilisation of funds by mutual funds during April-September 2005 increased by 18.0 per cent to Rs.5,00,123 crore over the corresponding period of the previous year. Most mutual fund schemes witnessed large inflows under their various schemes. As a result, net funds mobilised by mutual funds (net of redemptions) increased substantially by 193.6 per cent to Rs.36,822 crore during April-September 2005 over the corresponding period of the

Table 37: Mobilisation of Resources from the Primary Market

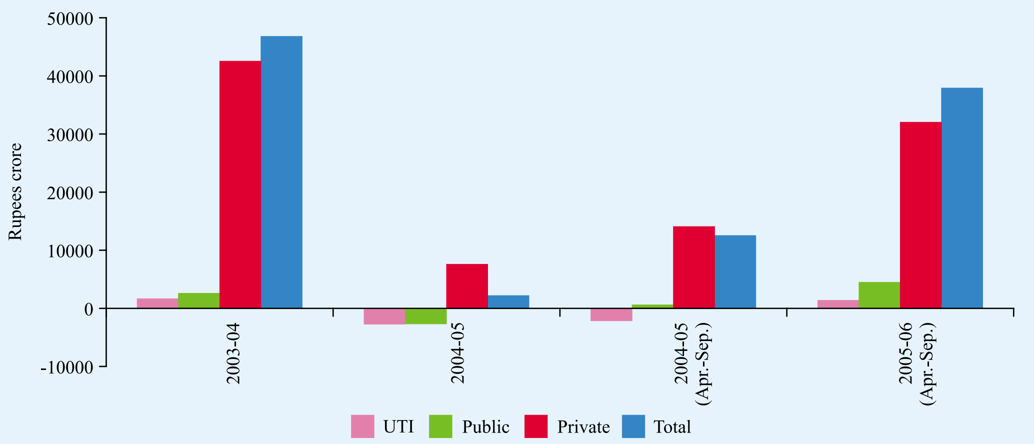
(Amount in Rupees crore)

Item	April-September 2004		April-September 2005 P	
	No. of Issues	Amount	No. of Issues	Amount
1	2	3	4	5
A. Prospectus and Rights Issues*				
1. Private Sector (a+b)	25	8,462	51	6,740
a) Financial	5	3,705	4	509
b) Non-financial	20	4,757	47	6,231
2. Public Sector (a+b+c)	-	-	4	3,892
a) Public Sector Undertakings	-	-	-	-
b) Government Companies	-	-	-	-
c) Banks/Financial Institutions	-	-	4	3,892
3. Total (1+2)	**25**	**8,462**	**55**	**10,632**
Of which:				
(i) Equity	25	8,462	54	10,514
(ii) Debt	-	-	1	118
B. Private Placement+				
1. Private Sector	143	7,111	239	12,475
a) Financial	79	4,655	83	7,368
b) Non-financial	64	2,456	156	5,107
2. Public Sector	29	4,555	39	7,980
a) Financial	11	1,760	29	4,170
b) Non-financial	18	2,795	10	3,810
3. Total (1+2)	**172**	**11,666**	**278**	**20,455**
Memo Item:				
Euro Issues	**6**	**1,367**	**17**	**3,828**

P : Provisional. * : Excluding offers for sale. + : April-June.

previous year. UTI Mutual Fund witnessed net inflows of Rs.1,376 crore during April-September 2005 as against net outflows of Rs.2,148 crore during the corresponding period of the previous year. The private sector and public sector mutual funds recorded net inflows of Rs.30,945 crore and Rs.4,501 crore, respectively, during April-September 2005 as compared with Rs.14,078 crore and Rs.608 crore, respectively, during April-September 2004 (Chart 49). Scheme-wise, 75.0 per cent of the gross mobilisation of funds was under liquid/ money market oriented schemes during April-September 2005. Net inflows were witnessed in case of both income/debt-oriented schemes and growth/ equity-oriented schemes. Net mobilisation of resources under growth/equity oriented schemes maintained its trend mainly due to attractive returns from these schemes in a buoyant secondary market.

Chart 49: Net Resource Mobilisation by Mutual Funds



Secondary Market

The stock markets remained buoyant during the first half of 2005-06. The BSE Sensex touched all time highs reaching the 8800 mark on October 4, 2005 reflecting strong macroeconomic fundamentals and robust corporate earnings (Table 38 and Chart 50). Strong liquidity support from both FIIs and mutual funds, satisfactory progress of monsoon, firm trend in the international markets and surge in ADR prices also helped to boost the market sentiment. Announcement of fresh reform measures such as allowing foreign private sector banks to acquire weak private sector banks in India, allowing 100 per cent foreign direct investment in construction sector and permitting pension funds to invest in equity markets also buoyed up the market. The stock markets, however, witnessed some correction in the period beginning October 5, 2005 due to slow down in FII inflows, cautious approach by investors ahead of second quarter corporate results, profit booking at higher levels and weak trend in international markets. The BSE Sensex stood at 7971 on October 19, 2005.

Table 38: Corporate Financial Performance

(Growth rates in per cent)

	2003-04	2004-05	2004-05				2005-06
			Q1	Q2	Q3	Q4	Q1
1	2	3	4	5	6	7	8
Sales	15.4	25.2	24.8	23.7	24.1	21.0	18.5
Expenditure	14.7	24.0	23.4	22.4	24.3	19.8	18.0
Gross Profits	26.6	38.9	36.0	35.8	30.5	35.3	32.0
Interest Cost	-11.5	-2.0	-3.2	2.1	-13.0	-5.4	-13.5
Profits After Tax	57.9	53.8	51.2	45.3	45.5	51.4	54.2
Memo :							
							(Amount in Rupees crore)
No. of Companies	2201	1273	1255	1353	1464	1301	2355
Sales	4,28,072	5,68,476	1,35,156	1,53,040	1,62,193	1,79,632	1,94,608
Expenditure	4,29,080	4,90,204	1,15,656	1,31,227	1,40,574	1,56,647	1,66,972
Gross Profits	48,852	72,406	17,234	20,448	20,017	23,736	25,577
Interest Cost	14,724	12,528	3,597	3,584	3,273	3,177	4,241
Profits After tax	26,281	47,333	10,396	13,004	13,196	16,798	16,726

Note : 1. Growth rates are percentage change in the level for the period under reference over the corresponding period of the previous year.

2. Data are based on the audited / unaudited abridged results of the non-financial non-Government companies except column (2) which are based on audited balance sheets for 2003-04.

During the current financial year so far (up to October 19, 2005), the BSE Sensex has risen by 22.8 per cent over its end-March level, while the S&P CNX Nifty has increased by 18.5 per cent. The price-earnings (P/E) ratio of BSE Sensex stood at 16.2 as on October 19, 2005 as compared with 15.6 at end-March 2005 (Table 39).

The rally in the stock markets has been broad-based. BSE 500 increased by 18.9 per cent on a point-to-point basis between October 19, 2005 and end-

Chart 50: Indian Stock Markets

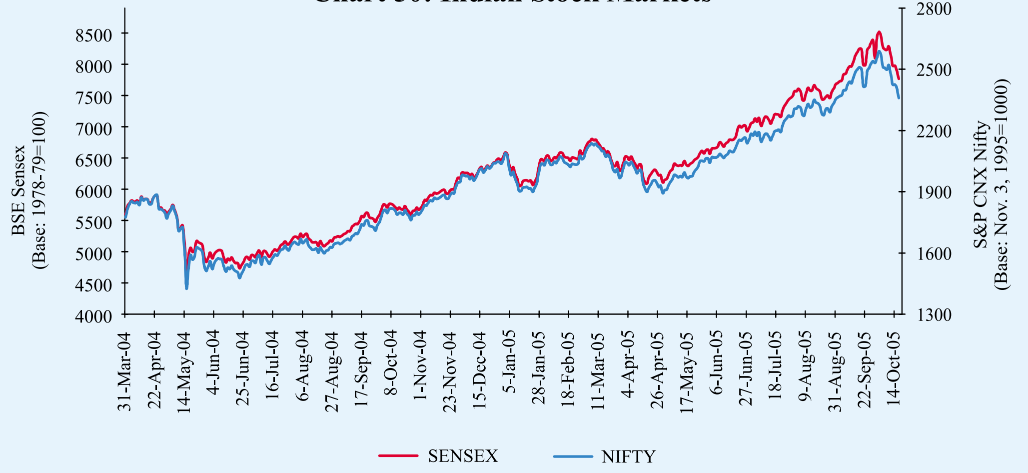


Table 39: Stock Market Indicators

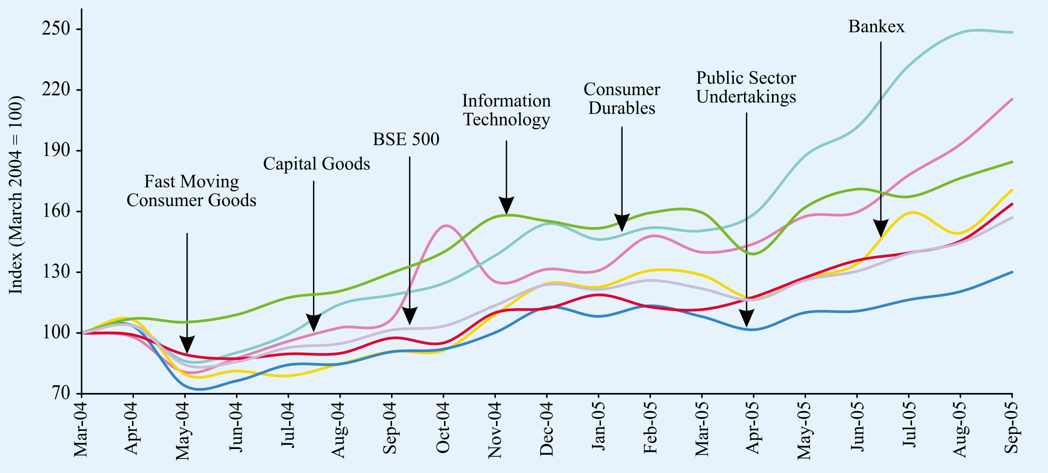
Indicator	BSE				NSE			
	2003-04	2004-05	April-September		2003-04	2004-05	April-September	
			2004-05	2005-06			2004-05	2005-06
1	2	3	4	5	6	7	8	9
Average BSE Sensex / S&P CNX Nifty	4492	5741	5221	7187	1428	1805	1642	2205
Volatility	23.0	11.2	6.8	9.6	23.3	11.3	7.3	8.8
P/E Ratio (End-period)*	18.6	15.6	16.7	17.8	20.7	14.6	14.6	16.2
Turnover (Rs. crore)	5,03,053	5,18,715	2,44,913	3,61,054	10,99,535	11,40,071	5,53,969	6,95,049
Market Capitalisation (Rs. crore) (End-period)	12,01,207	16,98,429	13,09,420	22,54,376	11,20,976	15,85,585	12,27,550	20,98,263

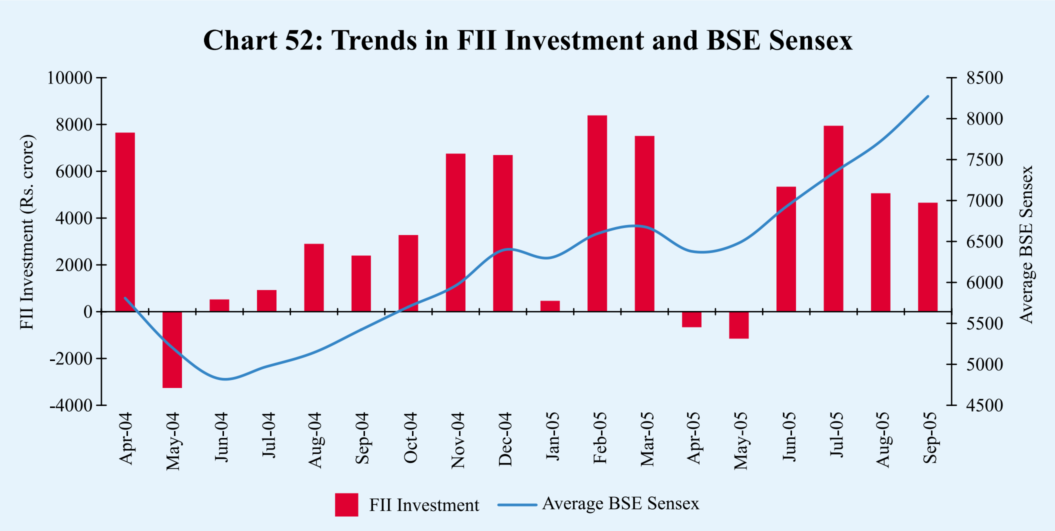
* : For 30 scrips included in the BSE Sensex and 50 scrips included in the S&P CNX NIfty.
Source: The Stock Exchange, Mumbai (BSE) and National Stock Exchange of India Ltd. (NSE).

March 2005. Amongst the major sectoral indices, the BSE consumer durables registered the highest gain (51.5 per cent) over end-March 2005, followed by capital goods (42.9 per cent), fast moving consumer goods (FMCG) (33.4 per cent), bankex (18.7 per cent), IT (13.9 per cent) and public sector undertakings (PSUs) (10.7 per cent) (Chart 51). The consumer durables index rose sharply on account of good corporate results led by increase in sales in electronics and auto segments and merger and acquisition activities. The FMCG sector performed well mainly due to satisfactory progress of monsoon which is expected to increase sales of the FMCG products. The capital goods scrips gained due to robust industrial activity, especially in the manufacturing sector and continued encouraging investment climate.

According to the Securities and Exchange Board of India (SEBI), FIIs made net investments of Rs.19,936 crore in the equity market during 2005-06

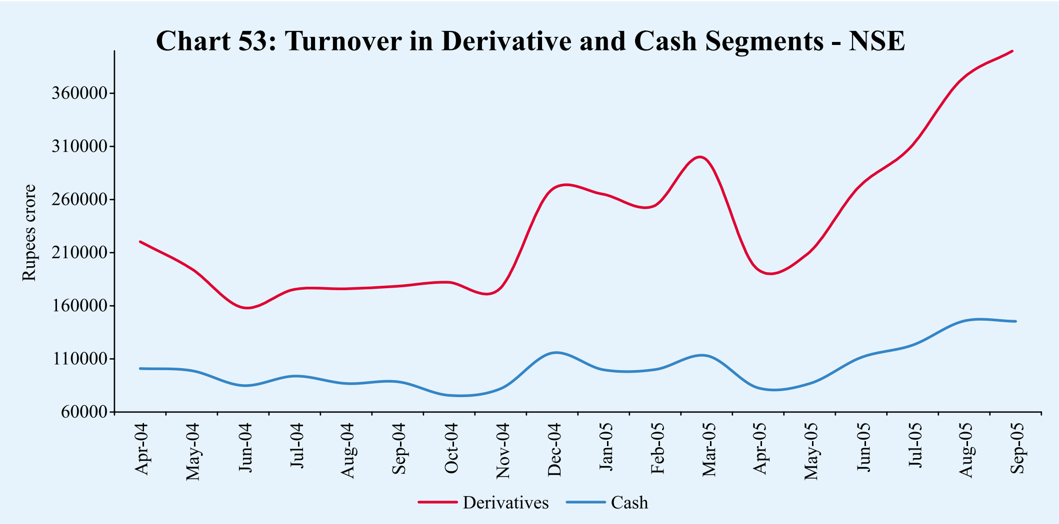
Chart 51: Trends in BSE Sectoral Stock Indices





so far (up to October 19, 2005), substantially higher than that of Rs.13,307 crore during the corresponding period of the previous year (Chart 52). Mutual funds also made net purchases in equities of Rs.9,831 crore during 2005-06 so far (up to October 18, 2005) in contrast to sales of Rs.845 crore during the corresponding period of the previous year.

At the NSE, the total turnover in the cash segment increased by 25.5 per cent to Rs.6,95,049 crore during April-September 2005. The turnover in the NSE's derivative segment continued to be higher than in the cash segment. It increased by 59.2 per cent to Rs.17,55,790 crore during April-September 2005 (Chart 53).



VI. THE EXTERNAL ECONOMY

Balance of payments (BoP) developments during the first quarter of 2005-06 point to a sharp turnaround in the current account balance, due to a widening of the merchandise trade deficit. Nonetheless, with capital flows remaining strong - led by foreign investment flows, direct as well as portfolio - and in excess of the current account deficit, the balance of payments position remained comfortable and the overall balance recorded a modest surplus. External debt recorded a modest decline during the quarter ended June 2005. Foreign exchange reserves have increased by US $ 1.9 billion in the current fiscal year so far to US $ 143.4 billion as on October 14, 2005. Various reserve adequacy indicators show that the current level of foreign exchange reserves is adequate.

International Developments

Despite record high international crude oil prices, global GDP growth has exhibited a considerable degree of resilience during 2005 so far. According to the International Monetary Fund (IMF), global economic activity is projected to grow by 4.3 per cent in 2005 on top of 5.1 per cent growth recorded in 2004 - which was a three-decade high - buoyed by strong corporate performance, accommodative macro policies and favourable financial market conditions. Following a temporary slowdown in mid-2004, global GDP growth picked up in the first quarter of 2005 benefiting from robust services sector which offset deceleration in manufacturing and trade. In the second quarter of 2005, record high oil prices exerted a drag on growth with leading indicators turning downward and business confidence weakening in major countries.

Growth divergence across regions, however, remains wide and growth continues to be led by the US and China (Table 40). Concomitantly, global current account imbalances have further accentuated with the US current account now projected to increase from 5.7 per cent of GDP in 2004 to 6.1 per cent in 2005 and stay at that level in 2006. Growth in Euro area remained subdued as the recovery in domestic demand that set in during the second half of 2004 has slowed down considerably. After gaining momentum in the first quarter of 2005, domestic demand in Japanese economy recovered further in the second quarter of 2005 on the back of a strengthening private consumption and business investment supported by improvements in labour market, high corporate profitability and improvement in business expectations.

As regards prospects for 2006, global GDP growth is projected by the IMF at 4.3 per cent, the same as in 2005, benefiting from still accommodative macroeconomic policies, and benign financial market conditions. However, high international crude oil prices, increasing protectionist sentiment, and widening global imbalances pose serious downside risks to growth prospects.

Global inflationary pressures, after remaining relatively contained during the first half of 2005, have witnessed some pick up in recent months. The main

Table 40: Growth Rates

(Per cent)

Country	2004	2004-Q2	2004-Q3	2004-Q4	2005-Q1	2005-Q2
1	2	3	4	5	6	7
Advanced Economies						
US	4.4	4.6	3.8	3.8	3.6	3.6
UK	3.1	3.7	2.1	2.9	2.1	1.5
Euro Area	2.1	2.2	1.8	1.5	1.4	1.1
Japan	1.9	3.2	2.6	0.6	1.3	1.4
OECD Countries	3.3	3.7	3.2	2.8	2.6	2.6
Emerging Economies						
China	9.5	9.6	9.1	9.5	9.4	9.5
Malaysia	7.1	8.0	6.8	5.6	5.7	4.1
Indonesia	5.1	4.3	5.0	6.7	6.4	5.5
South Korea	4.6	5.5	4.7	3.3	2.7	3.3
Thailand	6.9	6.4	6.1	5.1	3.3	4.4
Brazil	5.2	4.7	5.3	4.2	2.6	3.9
Argentina	9.0	7.1	8.7	9.1	8.0	10.1
India	**6.9@**	**7.6**	**6.7**	**6.4**	**7.0**	**8.1**

@: FY 2004-05.
Sources: The Economist and the OECD.

risks to global inflation outlook continue to be high international oil prices and persistent global imbalances between the US and the main regions of the world.

Growth in world trade during 2005 so far has remained strong although there was some loss of momentum from a year ago (Table 41). The world export growth of 14.3 per cent in US $ terms during January-May 2005 was underpinned by a volume growth of 5.7 per cent. The prices of non-oil primary commodities witnessed an increase of 8.0 per cent during January-May 2005 as compared with an increase of about 21.6 per cent during the corresponding period of the previous year.

Table 41: Growth in Merchandise Exports: Global Scenario

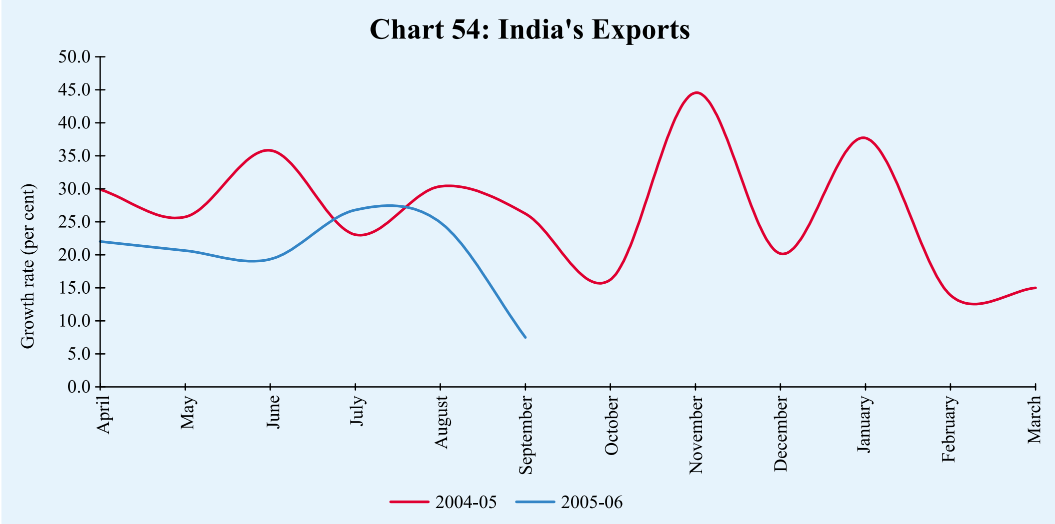
(Per cent)

Region/Country	2004	2004 (January-May)	2005 (January-May)
1	2	3	4
World	**21.2**	**20.2**	**14.3**
Industrial Countries*	17.4	17.8	9.7
USA*	12.9	13.2	10.3
Germany*	21.3	22.3	9.2
Japan*	19.9	23.2	5.6
Developing Countries	27.2	24.5	19.1
China*	35.5	33.5	34.0
India***	29.1	30.3	20.1
Korea**	31.0	36.8	11.8
Singapore**	24.6	25.3	14.8
Indonesia*	11.2	5.7	25.9
Malaysia	26.5	19.2	12.0
Thailand*	21.3	21.1	12.0

* January-July 2005. ** January-August 2005. *** January-September 2005.
Source: International Financial Statistics, International Monetary Fund, October 2005.

Merchandise Trade

India's foreign trade maintained a buoyant trend during April-September 2005. According to the Directorate General of Commercial Intelligence and Statistics (DGCI&S) data, exports growth in US dollar terms during April-September 2005 at 20.5 per cent was higher than the annual target of 16 per cent for the fiscal year set by the Government of India (Chart 54).



Export growth has been broad-based (Table 42). Exports of primary products were led by iron ore, reflecting increased global demand for metals. Among agricultural commodities, rice, coffee, raw cotton and cashew recorded a substantial pick-up in the wake of strong demand while tea, wheat, tobacco, oil meal and sugar suffered sharp deceleration. Exports of marine products showed a turnaround to a positive growth trajectory during April-August 2005 due to a pick-up in demand from Japan. In the manufacturing segment, engineering goods

Table 42: Export of Principal Commodities

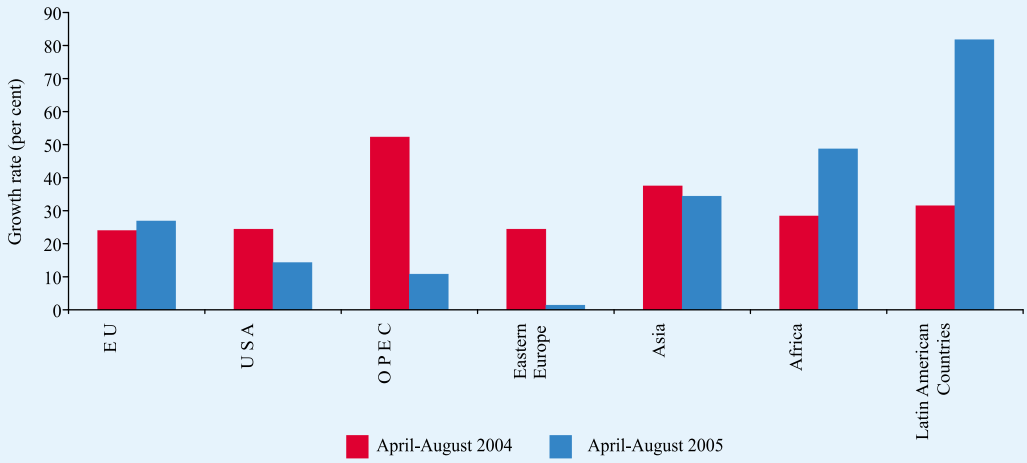
(Growth rate in per cent)

	2004-05	2004-05 (April-August)	2005-06 (April-August)
1	2	3	4
Agricultural and Allied Products	8.3	19.9	17.5
Ores and Minerals	104.2	75.2	48.6
Leather and Manufacture	7.4	19.7	6.0
Chemicals and Related Products	25.9	28.8	21.8
Engineering Goods	34.5	37.2	28.9
Gems and Jewellery	29.9	36.0	23.9
Handicrafts	-26.4	-13.0	9.6
Petroleum Products	90.5	75.1	61.3
Total Exports	**26.2**	**32.0**	**25.0**

(transport equipment, machinery and parts and iron and steel), gems and jewellery, and chemicals (dyes, intermediates and cosmetics and inorganic chemicals) remained the key drivers of export growth. In the textiles segment, the pick-up in readymade garments was driven by strong demand in major markets, *i.e.*, the US and Europe, reflecting the positive impact on India's textile industry in the post-MFA period. Exports of petroleum products recorded a growth of 61.3 per cent during April-August 2005 on top of 75.1 per cent a year ago, benefiting from elevated international oil prices and reflecting the competitive strength of India's petroleum refinery sector.

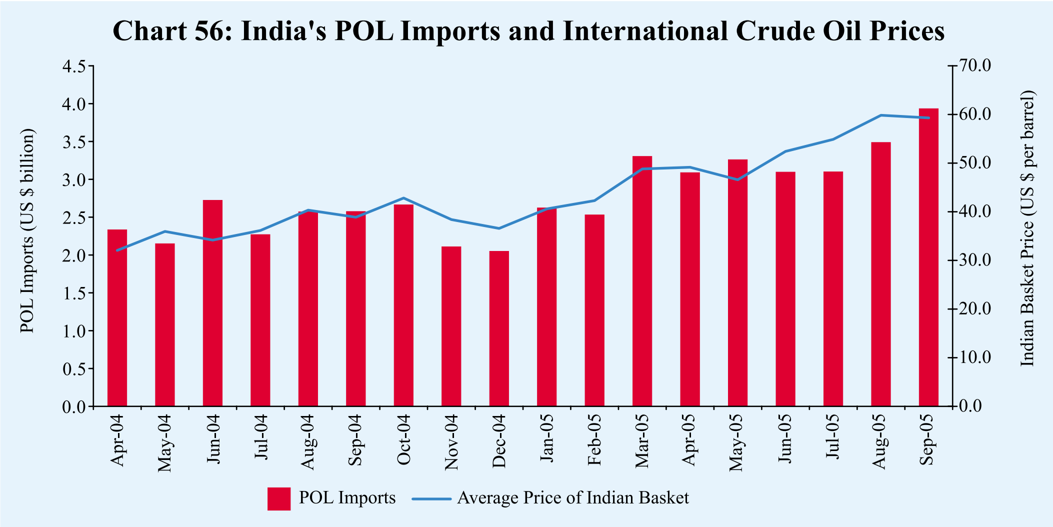
Latin America emerged as the fastest growing region for India's exports during April-August 2005, followed by Africa, East Asia and Europe. Singapore, China, Korea, Hong Kong, South Africa, the Netherlands, France and the UK were the major markets for India's exports (Chart 55).

Chart 55: Destination of India's Exports



Imports maintained the tempo of high growth, driven by both oil and non-oil imports, in an environment of buoyant economy. The rise in petroleum, oil and lubricants (POL) imports (42.9 per cent) in April-September 2005 was due to a sharp increase in international crude oil prices. The average crude oil price (Indian basket) touched the level of US $ 59.3 per barrel in September 2005, recording a rise of 52.6 per cent over the previous year (Chart 56). In volume terms, oil imports declined by 0.8 per cent during April-August 2005 (as against an increase of 12.7 per cent a year ago) even as indigenous production of crude oil declined by 6.7 per cent. Domestic consumption of petroleum products registered a decline of 2.9 per cent during April-July 2005.

Non-oil imports maintained a high growth (28.8 per cent) during April-September 2005 (29.8 per cent a year ago) in tune with the acceleration in industrial activity (Chart 57). Capital goods posting a growth of 33.5 per cent during April-August 2005 were the key drivers of non-oil imports. The expansion



of capital goods imports, accompanied by a strong growth of domestic production of capital goods, reflects a build-up in capacity of the industrial sector.

Among other major items, gold and silver imports maintained strong growth in April-August 2005 (Table 43). Imports of mainly export related items registered strong growth in April-August 2005 due to pearls, precious stones and semi-precious stones (38.6 per cent). Among bulk goods, fertiliser and non-ferrous metals registered a steep rise while edible oil and pulses recorded decline in April-August 2005.

During April-August 2005, China emerged as the largest source of India's imports, followed by Switzerland, the US, Belgium, UAE, Germany and Australia.

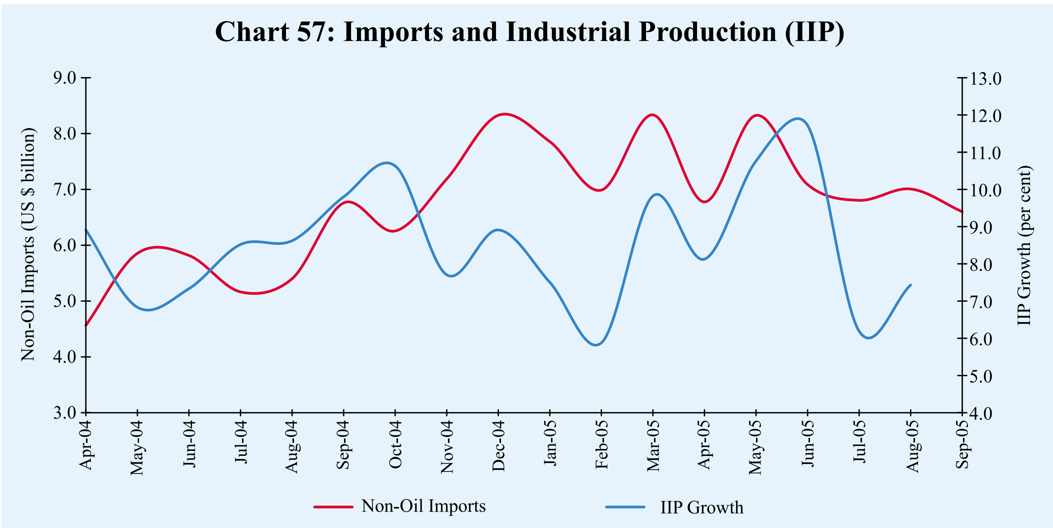


Table 43: Import of Principal Commodities

(Growth rate in per cent)

Item	2004-05	2004-05	2005-06
		April-August	
1	2	3	4
Petroleum and Products	45.1	58.4	40.8
Edible Oil	-4.6	-14.3	-15.2
Non-Ferrous Metals	33.0	41.1	37.4
Metalliferous Ores and Metal Scraps	84.8	72.2	51.4
Iron and Steel	72.3	74.5	109.9
Capital Goods	33.8	29.5	33.5
Pearls, Precious and Semi Precious Stones	32.2	22.8	38.6
Textile Yarn Fabric etc.	19.9	12.8	37.0
Chemicals	34.2	31.5	27.9
Gold and Silver	59.6	32.7	52.0
Total Imports	**37.0**	**37.1**	**39.4**

Trade deficit, based on DGCI&S data, surged by 71.0 per cent to US $ 20.3 billion during April-September 2005 (Table 44). The surge in non-oil imports, which increased by US $ 9.5 billion during April-September 2005, was the major factor underlying the expansion of trade deficit. During April-August 2005, the non-oil trade balance showed a deficit of US $ 4.8 billion as compared with a negligible deficit a year ago.

Table 44: India's Merchandise Trade

(US $ billion)

Item	2004-05	2004-05	2005-06
		April-September	
1	2	3	4
Exports	80.5	35.9	43.2
	(26.2)	(30.8)	(20.5)
Imports	109.2	47.7	63.6
	(39.7)	(37.3)	(33.1)
Oil	29.8	14.6	20.8
	(45.1)	(58.2)	(42.9)
Non-Oil	79.3	33.2	42.7
	(37.8)	(29.8)	(28.8)
Trade Balance	- 28.6	-11.9	-20.3

Note : Figures in parentheses show percentage change over the corresponding period of the previous year.
Source : DGCI&S.

Current Account

Net surplus under the invisibles account continued to remain sizeable during April-June 2005 (Table 45). Gross invisible receipts remained buoyant (45.5 per cent growth), reflecting the underlying dynamism in travel earnings, sustained pace of export of software and other business and professional services and stable remittances from overseas Indians. Software exports remained on the high growth trajectory during April-June 2005. Private transfers, comprising remittances from

Table 45: Invisibles Account (Net)

(US $ million)

Item	2004-05 (April-March)	2004-05 Apr.-Jun.	July-Sept.	Oct.-Dec	Jan.-Mar.	2005-06 (April-June)
1	2	3	4	5	6	7
Travel	-497	-335	-284	10	112	-560
Transportation	509	385	-4	85	43	-18
Insurance	294	12	57	111	114	44
Govt. not included elsewhere	142	95	10	40	-3	-5
Software	16,626	3,732	3,882	4,183	4,829	5,036
Other Services	-2,444	-640	-1,651	-1,784	1,629	-217
Transfers	21,048	5,959	4,481	4,592	6,016	6,235
Income	-3,979	-644	-1,353	-933	-1,049	-907
Investment Income	-2,848	-420	-1,097	-594	-737	-576
Compensation of Employees	-1,131	-224	-256	-339	-312	-331
Total	**31,699**	**8,564**	**5,138**	**6,304**	**11,691**	**9,608**

Indians working abroad, contributed about 23 per cent of gross invisible receipts. Invisibles payments surged (75 per cent) on account of growth in outbound tourist traffic, transportation and insurance payments associated with merchandise trade and rising import demand for business services such as business and management consultancy, engineering, technical and distribution services. On the whole, net invisible surplus during April-June 2005 was around US $ 1 billion higher than a year ago.

The net invisible surplus, however, fell short of the merchandise trade deficit which, on payments basis, nearly trebled to US $ 15.8 billion from the position a year ago in view of the large expansion in imports – both oil and especially, non-oil. Net invisible surplus thus could finance only 61 per cent of the trade deficit and the current account balance recorded a deficit of US $ 6.2 billion - a turnaround of US $ 9.6 billion from the position a year ago (Table 46).

Table 46: India's Balance of Payments

(US $ million)

Item	2004-05 (April-March)	2004-05 Apr.-Jun.	July-Sept.	Oct.-Dec	Jan.-Mar.	2005-06 (April-June)
1	2	3	4	5	6	7
Exports	80,831	17,840	18,875	20,888	23,228	21,754
Imports	1,18,961	23,014	28,514	32,673	34,760	37,563
Trade Balance	-38,130	-5,174	-9,639	-11,785	-11,532	-15,809
Invisibles, net	31,699	8,564	5,138	6,304	11,691	9,608
Gross Receipts	77500	18209	15721	18,665	24,903	26,496
Gross Payments	45801	9645	10583	12,361	13,212	16.888
Current Account	-6,431	3,390	-4,501	-5,481	159	-6,201
Capital Account*	32,590	4,180	3,867	12,075	12,470	7,448
Change in Reserves # (-Indicates increase)	-26,159	-7,570	634	-6,594	-12,629	-1,247

* : Includes errors and omissions.
\# : On balance of payments basis (excluding valuation).

Capital Flows

Capital flows to India remained strong during April-August of 2005-06, led by foreign investment flows. Foreign direct investment (FDI) inflows into India during April-August 2005 were 18 per cent higher than in the corresponding period of 2004, buoyed up by the pick-up in activity and positive investment climate. Industry-wise, FDI inflows were concentrated in cement, software supply services, food processing, textile, construction and financial services. Mauritius, US and UK continued to remain the dominant sources of FDI to India.

Portfolio investment flows witnessed a sharp turnaround during April-August, 2005 from the position a year ago. After remaining subdued during April-May 2005, Foreign Institutional Investors (FIIs) made large purchases in the Indian stock markets in the subsequent three months resulting in inflow under portfolio investment of US $ 3.8 billion during April-August 2005. The number of FIIs registered with the SEBI increased from 685 at end-March 2005 to 764 by end-August 2005 with the registration of FIIs from Australia, Austria, Canada, Denmark, Ireland, Italy, Sweden, Korea, Japan and Taiwan, providing a diverse FII base for investment in India. Portfolio flows through the issuances of American depository receipts (ADRs)/global depository receipts (GDRs) were higher during April-August 2005 as booming stocks offered corporates the opportunity to issue equities abroad.

Notwithstanding some firming up of international interest rates, demand for external commercial borrowings (ECBs) remained steady during April-June 2005 in consonance with the acceleration in industrial activity. Indian corporates indicated a preference for foreign currency convertible bonds (FCCBs) as these bond issuances are attractive due to lower spreads and conversion reduces the debt-servicing burden. Short-term trade credits, however, witnessed outflows as oil companies increased their recourse to domestic financing. As against net outflows during April-June 2004, Non-Resident Indian deposit accounts recorded net inflows of small magnitude during April-June 2005, primarily on account of inflows under the Non-Resident (External) Rupee Account [NR(E)RA] scheme (Table 47).

Table 47: Capital Flows

(US $ million)

Components	Period	2004-05	2005-06
1	2	3	4
Foreign Direct Investment into India	April-August	2,186	2,573
Portfolio Investment into India	April-August	98	3,796
FIIs	April-August	-72	3,219
ADRs/GDRs	April-August	170	568
External Assistance (Net)	April-June	36	204
External Commercial Borrowings (Net)			
(Medium and long-term)	April-June	1,075	924
Short-term Trade Credits (Net)	April-June	1,775	-230
NRI Deposits (Net)	April-June	-786	211

Foreign Exchange Reserves

During the first quarter of 2005-06, the current account deficit was more than offset by surplus in the capital account, resulting in an accretion to the foreign exchange reserves of the order of US $ 1.2 billion on a balance of payments basis (*i.e.*, excluding valuation effects).

India's foreign exchange reserves stood at US $ 143.4 billion as on October 14, 2005, registering an increase of US $ 1.9 billion over end-March 2005 level. At this level, India held the fifth largest stock of reserves among the emerging market economies and the sixth largest in the world. The overall approach to the management of India's foreign exchange reserves in recent years reflects the changing composition of the balance of payments and the 'liquidity risks' associated with different types of flows and other requirements. Taking these factors into account, India's foreign exchange reserves continued to be at a comfortable level and consistent with the rate of growth, the share of external sector in the economy and the size of risk-adjusted capital flows.

External Debt

India's total external debt was placed at US $ 122.1 billion at end-June 2005. At this level, the external debt stock declined by US $ 1.3 billion over the end-March 2005 level primarily reflecting the valuation effects of appreciation of the US dollar *vis-à-vis* other major international currencies. Component-wise, the reduction in external debt stock was mainly on account of a decline in multilateral and bilateral debt (Chart 58).

Chart 58: India's External Debt

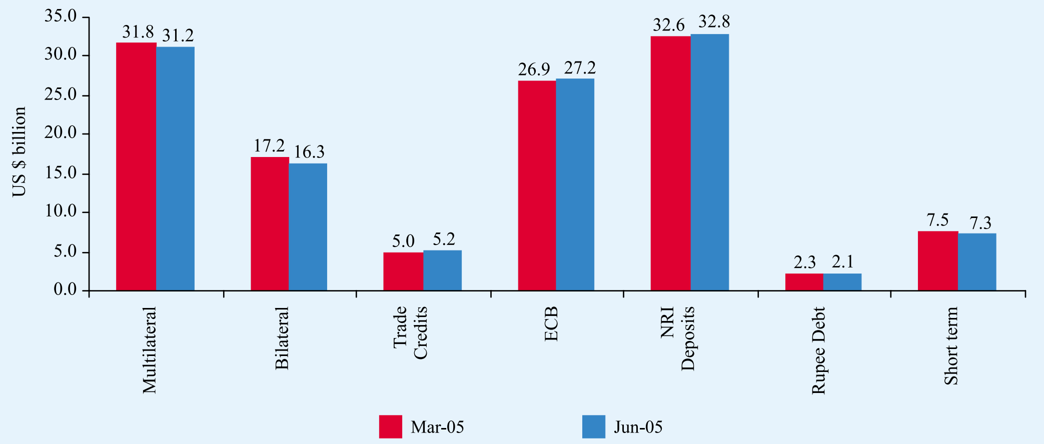


Table 48: Indicators of Debt Sustainability

(Per cent)

Indicator	March 2005	June 2005
1	2	3
Concessional debt/Total debt	33.5	32.6
Short-term/Total debt	6.1	6.0
Short-term debt/Reserves	5.3	5.3
Reserves/ Total debt	114.7	113.3

Over the years, there has been a perceptible improvement in external debt indicators reflecting the growing sustainability of external debt of India. This trend continued in April-June 2005 quarter also (Table 48). The ratio of short-term to total debt posted a marginal decline. The ratio of short-term debt to foreign exchange reserves remained stable. India's foreign exchange reserves exceeded the external debt by US $ 16.2 billion providing a cover of 113.3 per cent to the external debt stock at the end of June 2005. The share of concessional debt in total external debt continued its declining trend reflecting a gradual surge in non-concessional private debt. Nonetheless, the concessional debt continues to be a significant proportion of the total external debt, especially by international standards.

International Investment Position

India's international investment position improved further during 2004-05 as the increase (US $ 32.2 billion) in its external assets during the year outpaced that in external liabilities (US $ 26.0 billion). The increase in assets was mainly on account of reserve assets, reflecting the large overall surplus in the balance of payments. The expansion in external liabilities during 2004-05 was led by portfolio investment (mainly, FII inflows) followed by loans and direct investment. Consequently, India's net external liabilities continued their downward trajectory during the year. At end-March 2005, the ratio of India's net external liabilities to GDP at 6.3 per cent was one-half of the position two years ago (Table 49).

Table 49: International Investment Position of India

(US $ billion)

Period	March 2002	March 2003	March 2004	March 2005
1	2	3	4	5
A. Assets	**73.6**	**95.6**	**137.1**	**169.3**
	(17.2)	**(20.2)**	**(23.6)**	**(26.2)**
1. Direct Investment	4.0	5.8	7.1	9.6
2. Portfolio Investment	0.7	0.8	0.8	0.8
2.1 Equity Securities	0.3	0.4	0.4	0.4
2.2 Debt Securities	0.3	0.4	0.4	0.4
3. Other Investment	14.2	12.9	16.3	17.4
3.1 Trade Credits	0.8	1.1	1.9	3.9
3.2 Loans	2.2	1.4	1.7	1.8
3.3 Currency and Deposits	8.8	7.5	9.6	8.3
3.4 Other Assets	2.5	2.9	3.1	3.3
4. Reserve Assets	54.7	76.1	113.0	141.5
	(12.8)	(16.1)	(19.5)	(21.9)
B. Liabilities	**142.7**	**156.0**	**184.1**	**210.1**
	(33.3)	**(32.9)**	**(31.8)**	**(32.5)**
1. Direct Investment	25.4	31.2	39.1	44.5
	(5.9)	(6.6)	(6.7)	(6.9)
2. Portfolio Investment	31.5	32.4	43.7	55.5
	(7.4)	(6.8)	(7.5)	(8.6)
2.1 Equity Securities	18.6	20.1	34.0	42.8
2.2 Debt securities	12.9	12.3	9.8	12.7
3. Other Investment	85.8	92.4	101.3	110.2
	(20.0)	(19.5)	(17.5)	(17.0)
3.1 Trade Credits	3.8	4.8	6.3	9.6
3.2 Loans	62.7	61.1	61.9	65.9
3.3 Currency and Deposits	18.5	25.6	32.2	33.5
3.4 Other Liabilities	0.7	0.9	0.9	1.2
C. Net Position (A-B)	**-69.1**	**-60.4**	**-47.0**	**-40.9**
	(-16.1)	**(-12.7)**	**(-8.1)**	**(-6.3)**

Note: Figures in parenthesis are percentages to GDP.