Chapter I

Overview

Global Economy

1.1 Global economic growth remained strong in 2004 (January to December), aided by expansionary monetary policies and comfortable financial conditions[1]. Global growth, which was robust during the first half of 2004, slowed down somewhat in the latter part of the year, reflecting the impact of a sharp rise in commodity prices and the fear of disorderly movement of currency adjustments. However, the global economy grew by nearly 5 per cent in 2004, the highest rate for nearly three decades. The US and the emerging Asia accounted for more than half of the increase in global output. Growth in the euro area and Japan registered a much lower growth. With moderation in the global growth in the second half of 2004, growth differentials among different regions widened. While the US was able to sustain its growth on account of increased corporate spending and stronger job creation, the euro area and Japan faced renewed weakness. Large and persistent growth differentials in the growth pattern in different regions led to a significant widening of global financial imbalances.

1.2 Global inflation remained at a moderate level during 2004, despite the sharp increase in oil and non-oil commodity prices and accommodative monetary and fiscal policies. The inflationary impact of rising oil prices was felt more by the emerging market economies, which depend heavily on oil than the advanced industrial economies. This, combined with the impact of a rise in food prices, resulted in an increase in headline inflation in Asia from about 3 per cent at the beginning of 2004 to a peak of almost 5 per cent in the third quarter. In the advanced industrial economies, consumer price inflation increased from 1.5 per cent at the beginning of 2004 to about 2.5 per cent towards the end of the year. The inflation situation also deteriorated in the central and eastern Europe following several years of disinflation. Nevertheless, underlying inflationary pressures remained generally contained in most parts of the globe. Core inflation (excluding food and energy components from headline inflation) remained broadly stable in several advanced and emerging market economies.

1.3 Financial markets conditions remained comfortable with ample liquidity, notwithstanding reversal of accommodative monetary policy by the US beginning June 2004. Long-term rates fell in the US, despite rise in short-term interest rates. This was in sharp contrast to previous periods of monetary tightening, when high policy rates were accompanied by high long-term interest rates. The same trend was also observed in the UK, Australia, Canada and Switzerland, where long-term yields fell despite tightening of monetary policy. As a result, the yield curve flattened in several advanced economies. Credit spreads for corporate and sovereign borrowers declined to historical low levels, which helped in keeping borrowing costs down. Equity markets rallied in most of the major international markets, propelled by expectations of strong future corporate earnings on the back of strong economic recovery.

Developments during 2005

1.4 Global economic growth during 2005 is expected to be moderated. Following a temporary slowdown in mid-2004, global GDP growth picked up through the first quarter of 2005, with robust services sector output more than compensating slowing global growth in manufacturing. In the second quarter, however, the growth slackened reflecting, in part, the impact of higher oil prices and weakening of leading indicators and business confidence in most major countries. While global manufacturing and trade are now strengthening and leading indicators have shown improvement, high and volatile oil prices, exacerbated by the recent catastrophic effects of Hurricane Katrina continue to affect the growth prospects. The IMF has estimated the global growth to average 4.3 per cent in 2005 from 5.1 per cent in 2004. Within this overall favorable picture, there remain wide divergences in growth with the US, China and India continuing to lead global growth. While

[1] Global developments in this Chapter relate to the calendar year (January-December), while those on the Indian economy relate to the fiscal year (April-March), unless otherwise specified.

Japan appears to be regaining momentum, the expansion in the euro area continues to be subdued.

1.5 Financial market conditions continue to remain benign. Long-run interest rates, while somewhat volatile, continue to be unusually low around the world. Equity markets have remained resilient globally, supported by strong corporate profits and balance sheets. Credit spreads remain moderate. The current configuration of good growth, low inflation, abundant liquidity, flat yield curves, lowering of credit risk premia and ever-expanding search for yield has benefited many emerging market economies (EMEs). EMEs have strengthened their macro fundamentals in an environment of low inflation, improved fiscal positions and balance of payments and substantial accumulation of foreign exchange reserves.

1.6 The rising global financial imbalances remain a major risk to the economic outlook over the medium-term. Unusually low investment rates in several economies have resulted in an excess supply of saving at the global level, resulting in low real interest rates. While the US continues to finance the current account deficit without difficulty, there is a risk that higher than expected inflation or reduced interest in the US assets may cause sharp currency readjustments with implications for financial markets.

Indian Economy

Macro Environment

1.7 The Indian economy continued to register robust growth during 2004-05 (April to March), notwithstanding some setback arising from a deficient monsoon. Real GDP growth rate at 6.9 per cent in 2004-05, one of the highest in the world, came on the back of a 15-year high real GDP growth rate of 8.5 per cent in 2003-04. Overall real GDP growth for 2004-05 at 6.9 per cent, despite a sharp slowdown in agriculture, propelled the average growth to 6.5 per cent in the first three years of the Tenth Five Year Plan period (2002-03 to 2006-07). Growth of real GDP originating from 'agriculture and allied activities' decelerated sharply to 1.1 per cent during 2004-05 from 9.6 per cent during the previous year. Real GDP growth originating from industry, however, strengthened to 8.3 per cent with the industrial recovery spreading across almost all sectors during 2004-05. The firming up and spread of the upturn in industrial activity was led by manufacturing growth facilitated by positive investment climate, improved business confidence and buoyant external demand. The services sector contributed as much as 70.5 per cent to the real GDP growth in 2004-05.

1.8 The inflation rate in 2004-05 was somewhat higher than that in 2003-04, driven mainly by the rise in oil prices. It was, however, contained by successful policy interventions, both fiscal and monetary measures. Headline inflation, measured by year-on-year changes in the wholesale price index moved in two distinct phases during 2004-05. The first phase covering April-August 2004 witnessed a hardening of domestic prices of coal, petroleum products, iron ore and metals, reflecting lagged adjustments to international prices. Inadequate South-West monsoon also pushed up the prices of food and non-agricultural commodities between July and August 2004. Inflation receded in the second phase beginning September 2004 as the adverse impact of the South-West monsoon turned out to be far more limited than earlier perceived. The year-on-year headline inflation eased to 5.1 per cent by end-March 2005. For the year 2004-05 as a whole, inflation (in terms of WPI), on an average basis, was somewhat higher at 6.4 per cent than 5.4 per cent recorded in 2003-04.

1.9 The conduct of fiscal policy during 2004-05 was shaped by the Fiscal Responsibility and Budget Management (FRBM) Act, 2003 and the FRBM Rules, 2004. The revised fiscal deficit of the Centre for 2004-05 at 4.5 per cent of GDP was the same as the threshold level set by the FRBM. Provisional accounts of the Central Government released subsequently placed all the key deficit indicators lower than the revised estimates, reflecting higher non-tax revenues and lower capital expenditure. The gross fiscal deficit was placed lower at 4.1 per cent of GDP. The primary deficit and the revenue deficit also declined further as proportion of GDP.

1.10 Broad money (M_3) growth at 12.2 per cent during 2004-05 was lower than that of 16.7 per cent in 2003-04 and well within the projected trajectory of 14.0 per cent. The deceleration in M_3 reflected, in part, the base effect of higher deposit mobilisation by commercial banks during the last quarter of the previous year. A noteworthy feature during the year was the acceleration in bank credit to the commercial sector. The pick-up in the commercial banks' non-food credit, which started in July 2004, was sustained by the continued buoyancy in the industrial sector. In addition, the flow of resources from non-banks to the corporates, including issuance of Global and American Depository Receipts (GDRs and ADRs), Foreign Currency Convertible Bonds (FCCBs), and commercial paper (CP) almost doubled during the year.

1.11 Liquidity conditions in the various segments of money market remained broadly stable during 2004-05. The weighted average call money rate firmed up slightly to 4.77 per cent in March 2005 from 4.37 per cent in March 2004. The volatility in call money rates was somewhat higher during 2004-05 than in the preceding year, mainly on account of fluctuations in call rates during November-December 2004. Similarly, the cut-off yields on 91-day and 364-day Treasury Bills increased to 5.32 per cent and 5.66 per cent, respectively, in March 2005 from 4.37 per cent and 4.44 per cent, respectively, in March 2004. The market for CP continued to remain buoyant during 2004-05. The weighted average discount rate on commercial paper of 61-day to 90-day maturity moved up from 5.11 per cent in March 2004 to 5.84 per cent in March 2005. The repo rates ranged between 3.70 per cent and 5.58 per cent during the year, with the exception of occasional spikes in November and December 2004. The yields on Government securities with a 5-year and 10-year maturity hardened to 6.36 per cent and 6.65 per cent, respectively, in March 2005 from 4.78 per cent and 5.15 per cent, respectively, in March 2004.

1.12 Buoyant exports emerged as a driver of demand in a large spectrum of industries. Merchandise export growth exceeded 24 per cent in US dollar terms, extending the phase of high growth that began in 2002-03. The current account surplus, however, slipped into a modest deficit after being in surplus for three consecutive years. Capital inflows continued on account of global liquidity conditions as well as strong macroeconomic fundamentals of the Indian economy. Inflows of foreign direct investment increased substantially with India being one of the major recipients of foreign direct investment in the Asian region. Although portfolio flows declined on account of a slowdown during the first half of the year due to global uncertainties caused by hardening of crude oil prices and the upturn of the interest rate cycle, portfolio flows to India on the whole, accounted for 30.6 per cent of global flows to emerging market economies and developing countries in 2004. All these factors resulted in an accretion of foreign exchange reserves of US $ 26.2 billion during the year. The foreign exchange reserves at US $ 141.5 billion at end-March 2005 was the fifth largest stock of international reserves in the world, sufficient to finance about 14 months of imports. The ratio of short-term debt to foreign exchange reserves at 5.3 per cent comfortably satisfied the adequacy criterion *vis-à-vis* comparable countries.

Scheduled Commercial Banks

1.13 The robust macroeconomic environment continued to underpin the financial performance of Indian banks during 2004-05, with major bank groups successfully weathering the impact of an upturn in interest rate cycle. The demand for credit was broad-based during 2004-05 with agriculture and industry joining the housing and retail sectors to drive up the demand for credit. A sharp increase in net interest income mitigated to a large extent the impact of a sharp decline in non-interest income mainly on account of decline in trading profits. Banks continued to earn sizeable profits *albeit* somewhat lower than last year. Asset quality of scheduled commercial banks improved further during 2004-05 (Table I.1). Capital base of banks kept pace with the sharp increase in risk-weighted assets.

1.14 Aggregate deposits of SCBs increased at a lower rate during 2004-05 as compared with the previous year on account of slowdown in demand deposits and savings deposits. Deceleration in demand deposits was due mainly to the base effect as demand deposits had witnessed an unusually high growth last year. Reversing the decelerating trend of the previous year, bank credit registered a robust growth during the year. Although banks' investments in Government securities during the year 2004-05 slowed down significantly, the banking sector at end-March 2005 held about 38.4 per cent of its net demand and time liabilities in SLR securities, much in excess of the statutory minimum requirement of 25 per cent. The non-SLR investments of SCBs continued to decline during 2004-05, reflecting the portfolio adjustment by banks subsequent to guidelines on non-SLR securities issued by the Reserve Bank in November and December 2003.

Table I.1: Select Financial Sector Indicators: 2003-04 *vis-à-vis* 2004-05

Banks/FIs/NBFCs	Indicator	2003-04	2004-05
1	2	3	4
1. Scheduled Commercial Banks*	a) Growth in Major Aggregates (per cent)		
	Assets	16.2	15.2
	Deposits	16.4	15.4
	Investments	15.9	4.8
	Advances	16.9	27.9
	b) Financial Indicators (as percentage of total assets)		
	Operating Profits	2.7	2.2
	Net Profits	1.1	0.9
	Spread	2.9	2.9
	c) Non-Performing Assets (as percentage of advances)		
	Gross NPAs	7.2	5.2
	Net NPAs	2.9	2.2
2. Urban Co-operative Banks	a) Growth in Major Aggregates (per cent)		
	Deposits	1.7	0.7
	Credit	3.4	-1.5
	Investments	14.6	-2.5
	b) Financial Indicators (as percentage of total assets) #		
	Operating Profits	1.4	0.9
	Net Profits	0.4	0.3
	Spread	1.6	1.9
	c) Non-Performing Assets (as percentage of advances)		
	Gross NPAs	22.7	23.0
	Net NPAs	12.1	12.2
3. All-India Financial Institutions	a) Growth in Major Aggregates (per cent)[1]		
	Sanctions	81.4	-37.2
	Disbursements	42.2	-29.5
	b) Financial Indicators (as percentage of total assets)[2]		
	Operating Profits	1.7	2.5
	Net Profits	1.2	2.0
	Spread	1.1	1.7
	c) Non-Performing Assets (as percentage of advances)[2]		
	Net NPAs	5.6	3.7
4. Non-banking Financial Companies (excluding RNBCs)	a) Growth in Major Aggregates (per cent)		
	Public Deposits	-14.3	-15.5
	b) Financial Indicators (as percentage of total assets)		
	Net Profits	1.6	1.7
	c) Non-Performing Assets (as percentage of advances)		
	Net NPAs	2.4	3.4
5. Residuary Non-banking Companies (RNBCs)	a) Growth in Major Aggregates (per cent)		
	Public Deposits	1.7	8.3
	b) Financial Indicators (as percentage of total assets)		
	Net Profits	1.0	0.5

* : For the year 2004-05, data exclude the conversion of a non-banking entity into a banking entity.
\# : Relating to scheduled urban co-operative banks.
1. Relating to IFCI, IIBI, IDFC, SIDBI, IVCF, ICICI Venture, TFCI, LIC, GIC, NIA and UIA.
2. Relating to IFCI, IIBI, TFCI, IDFC, Exim Bank, NABARD, NHB and SIDBI.

Note : Data for 2004-05 are provisional.

1.15 Interest rates offered by the public sector banks on term deposits for maturities up to one year moved from a range of 3.75-5.25 per cent in March 2004 to 2.75-6.00 per cent in March 2005. Interest rates on term deposits with over one year maturity moved from a range of 5.00-6.00 per cent to 4.75-7.00 per cent during this period. The spread between typical deposit rates of 15-29 days and over 3-year tenor offered by public sector banks widened to 200 basis points in March 2005 from 175 basis points a year ago.

1.16 The benchmark prime lending rates (BPLRs) of public sector banks moved from a range of 10.25-11.50 per cent in March 2004 to 10.25-11.25 per cent in March 2005. BPLRs of foreign and private sector banks moved from a range of 11.00-14.85 per cent and 10.50-13.00 per cent, respectively, to 10.00-14.50 per cent and 11.00-13.50 per cent, respectively, during the same period. During 2004-05, a substantial part of banks' lending was at sub-BPLR rates. The share of sub-BPLR lending in total lending of commercial banks, excluding export credit, increased from about 50 per cent in March 2004 to over 60 per cent in March 2005. As at end-March 2005, public sector banks' median (representative) lending rate for demand and term loans (at which maximum business is contracted) in the range of 9.00-12.50 per cent and 8.35-12.00 per cent, respectively, exhibited moderation as compared with their corresponding levels of 11.00-12.75 per cent each in March 2004.

1.17 The gross and net NPAs of SCBs declined in absolute terms over and above the decline during the previous two years. The decline, however, was more pronounced in respect of net NPAs. The decline in net NPAs was witnessed across all bank groups. Various factors such as improved risk management practices, greater recovery efforts under the SARFAESI Act and Corporate Debt Restructuring mechanism, *inter alia*, contributed to the decline in the NPAs.

1.18 Banks were able to maintain capital to risk-weighted assets ratio (CRAR) more or less at the previous year's level, despite sharp increase in risk-weighted assets. While CRAR of new private sector banks increased, it declined marginally in respect of all other bank groups. Within the public sector banks, while the CRAR of nationalised banks remained more or less at the previous year's level, it declined for the State Bank group.

Co-operative Banks

1.19 Deposits of urban co-operative banks (UCBs) increased marginally, while their advances and investments declined during 2004-05. Business operations of scheduled UCBs expanded on the back of a sharp increase in internal resources, deposits and borrowings. The increase in net interest income of scheduled UCBs was offset by a decline in other income, resulting in reduced operating profit and net profit for the sector. Asset quality of urban co-operative banks did not witness any significant change during the year.

1.20 The rural co-operative banks exhibited divergent trends during 2003-04. Despite expansion of operations at a higher rate, the profitability of State co-operative banks declined. The trend was opposite for central co-operative banks. The grassroot layer of the rural co-operative banking structure, *i.e.*, the primary agricultural co-operative societies (PACS) expanded their membership, even as their borrowing members declined sharply. Overall operations of PACS, however, continued to expand during 2003-04, despite decline in deposits. Although there was some improvement in their asset quality, overdues continued to remain very high. The operations of the longer-term rural co-operatives structure, *i.e.*, the State Co-operative Agricultural and Rural Development Banks (SCARDBs) and Primary Co-operative Agricultural and Rural Development Banks (PCARDBs), witnessed a moderate growth. However, their financial performance remained unsatisfactory. The asset quality of all the layers of the rural co-operative banks, other than PACS, deteriorated.

Financial Institutions

1.21 Financial assistance sanctioned and disbursed by financial institutions (FIs) declined during 2004-05. Resources mobilised by FIs (excluding erstwhile Industrial Development Bank of India Ltd. - IDBI) increased, with National Bank for Agriculture and Rural Development (NABARD) mobilising the largest amount, followed by Export-Import Bank of India (EXIM Bank), National Housing Bank (NHB) and Industrial Development Finance Company (IDFC). Borrowings by way of bonds/debentures continued to be the main source of funds for FIs. Certain FIs such as IFCI Ltd. and Industrial Investment Bank of India (IIBI) Ltd. continued to be barred from mobilising fresh resources on account of their poor financials.

1.22 Loans and advances which represent the main avenue for deployment of funds by FIs registered healthy growth during 2004-05. The spread (net interest income) and the operating profits increased both in absolute terms and as a ratio to total assets. The capital to risk-weighted assets ratio remained much above the norm of 9 per cent at end-March 2005 for all FIs except IFCI Ltd. and IIBI. The asset quality of all FIs, except Small Industries Development Bank of India (SIDBI) showed a significant improvement during 2004-05 on account of substantial recovery of dues and increased provisioning.

Non-Banking Financial Companies

1.23 The number of Non-Banking Financial Companies (NBFCs) continued to decline largely on account of conversion of large sized deposit taking companies into non-deposit taking activities. Assets of NBFCs (excluding RNBCs), which contracted sharply during 2003-04, increased marginally during 2004-05. Financial performance of NBFCs improved in 2003-04 and 2004-05 mainly on account of containment of expenditure. While gross NPAs declined in 2003-04 and 2004-05, net NPAs increased somewhat during 2004-05. The CRAR of NBFCs continued to be comfortable with most of the NBFCs continuing to hold CRAR significantly above the regulatory minimum prescribed. Assets of RNBCs declined during 2003-04 and 2004-05. Financial performance of RNBCs was lacklustre during 2003-04 and 2004-05.

Developments during 2005-06

1.24 The Annual Policy Statement released in April 2005 projected real GDP growth for 2005-06 at around 7.0 per cent on the assumption of normal monsoon and that the industry and services sectors would maintain their growth momentum, while absorbing the impact of oil prices. Although the onset of the South-West monsoon was delayed this year by a week, it picked up by end-June 2005, as a result of which excess or normal rainfall was observed in 32 of the 36 meteorological sub-divisions. For the country as a whole, rainfall during June-September this year was 99 per cent of its long period average. By current assessment of area coverage under various crops, it is likely that the *kharif* output may register an increase over the previous year's level. In addition, the improvement in water storage levels over the previous year augurs well for the outlook on *rabi* production. Based on the current assessment of a pick-up in agricultural output and in the momentum in industrial and services sectors, the Mid-term Review of the Annual Policy Statement released in October 2005, placed GDP growth in 2005-06 in the range of 7.0-7.5 per cent as against around 7.0 per cent projected earlier in April 2005. According to data released by the Central Statistical Organisation (CSO), real GDP increased by 8.1 per cent during the first quarter of 2005-06 as against 7.6 per cent in the first quarter of the previous year. The elevated level of international crude prices imparts downside risks to overall GDP growth. At the same time, the robust industrial and service sector growth and buoyant exports are likely to have some positive impact on growth. Prospects for sustained growth in industrial output have improved in an environment of rising investment and export demand, strong corporate profitability and buoyant business confidence. The index of industrial production (IIP) increased by 8.8 per cent during April-August 2005 as compared with the increase of 8.0 per cent in the corresponding period of the previous year. There are signs of sustained growth in the production of basic goods, capital goods and consumer goods. Alongwith the sustained growth of industry, there was a surge in non-food credit growth. Exports of manufactured goods and services remain buoyant and the international business environment and investor confidence in India continue to remain positive. Domestic production and imports of capital goods have risen strongly in tandem, indicative of ongoing capacity expansion. With continued business expansion and lower interest costs, corporate profitability is high and there is an expansion in internal resources available for investment. These factors have led to upbeat sentiment and a positive investment climate.

1.25 Monetary conditions remained comfortable during 2005-06 (up to September 30, 2005), 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. The year-on-year growth in M_3 at 16.6 per cent up to September 30, 2005 was higher than the indicative trajectory of 14.5 per cent indicated in the Annual Policy Statement for 2005-06.

1.26 Financial markets have remained stable and orderly, although interest rates have firmed up in almost all segments. The average call money rate increased from 4.77 per cent in April 2005 to 5.06 per cent in October 2005 (up to October 21) although it generally remained closely aligned with the LAF reverse repo rate. The 91-day and the 364-day Treasury Bill rates also increased from 5.12 per cent and 5.60 per cent, respectively, in April 2005 to 5.53 per cent and 5.85 per cent, respectively, by October 2005. The 182-day Treasury Bill rate moved up from 5.21 per cent to 5.78 per cent during the same period. The yield on Government security with 1-year residual maturity in the secondary market increased from 5.66 per cent in April 2005 to 5.88 per cent in October 2005. The yield on Government securities with 10-year and 20-year residual maturities increased from 6.68 per cent and 7.08 per cent, respectively, to 7.18 per cent and 7.52 per cent, respectively. With a relatively higher increase in the long-term yields, there was a steepening of the yield curve. The yield spread between 10-year and 1-year Government securities moved up from 102 basis points to 130 basis points, whereas the spread between 20-year and 1-year Government securities increased from 142 basis points to 164 basis points.

1.27 The weighted average discount rate on CP of 61 days to 90 days maturity increased from 5.80 per cent in April to 5.89 per cent by mid-October 2005. The market repo rate increased from 4.63 per cent to 4.85 per cent with an increase in daily volume from Rs.3,958 crore (one leg) to Rs.5,661 crore by September 2005. The average daily volume of CBLO (collateralised borrowing and lending obligation) increased significantly from Rs.5,185 crore to Rs.8,572 crore along with an increase in the CBLO rate from 4.58 per cent to 4.80 per cent. The typical interest rate on 3-month certificates of deposit (CDs) increased from 5.87 per cent in April to 5.90 per cent by mid-September 2005. Public sector banks kept their rates for deposits of over one year maturity unchanged in the range of 5.25-6.50 per cent during April-September, 2005. The benchmark prime lending rates (BPLRs) of public sector banks, private sector banks and foreign banks remained unchanged in the range of 10.25-11.25 per cent, 11.00-13.50 per cent and 10.00-14.50 per cent, respectively.

1.28 Inflation, as measured by variations in the wholesale price index (WPI) on a point-to-point basis, receded to 4.5 per cent as on October 22, 2005 from 7.4 per cent a year ago. On an annual average basis, inflation based on the WPI was 5.2 per cent as on October 22, 2005 as against 6.3 per cent a year ago.

1.29 The Indian foreign exchange market generally witnessed orderly conditions during the current financial year so far (up to October 21, 2005). The exchange rate of the rupee, which was Rs.43.75 per US dollar at end-March, 2005 depreciated by 3.0 per cent to Rs.45.09 per US dollar by October 21, 2005. However, it appreciated by 4.2 per cent against the Euro, by 2.5 per cent against the Pound sterling and by 4.5 per cent against the Japanese yen during the period. Forward premia continued to decline in tandem with narrowing interest rate differential following further hikes in the US interest rates.

1.30 Aggregate deposits of scheduled commercial banks rose by 12.3 per cent up to September 30, 2005 as compared with an increase of 6.8 per cent in the corresponding period of the previous year. On an annual basis, the growth in aggregate deposits at 18.6 per cent, net of conversion, was higher than that of 15.8 per cent a year ago. Scheduled commercial banks' credit increased by 14.2 per cent up to September 30, 2005, which was higher than the increase of 11.7 per cent in the corresponding period of last year. Food credit recorded a decline from its end-March level, reflecting lower procurement of foodgrains during the current financial year. On the other hand, non-food credit posted an increase of 14.8 per cent as compared with an increase of 11.9 per cent in the corresponding period of the previous year. While the outstanding credit-deposit ratio increased to 65.8 per cent from 58.4 per cent a year ago, the incremental non-food credit-deposit ratio declined to 75.2 per cent as compared with 92.9 per cent. Among non-bank sources of funds, corporates raised large resources by way of equity issues during April-September 2005, benefiting from buoyancy in the equity markets. The CP market remained buoyant, reflecting the continued issuances of CP from leasing and finance companies.

1.31 Banks financed the strong demand for credit by the commercial sector by mainly restricting their incremental investments in Government securities. Incremental investments by commercial and co-operative banks in Government papers during the first half of 2005-06 were less than one-third 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 NDTL from nearly 40 per cent a year ago, but were still in excess of the statutory minimum requirement of 25 per cent.

1.32 India's exports during April-September, 2005 increased by 20.5 per cent in US dollar terms as compared with 30.8 per cent in the corresponding period of the previous year. India's merchandise export growth surpassed that of most Asian countries during this period. Imports rose by 33.1 per cent as against an increase of 37.3 per cent in the corresponding period of last year. While oil import growth moderated to 42.9 per cent from 58.2 per cent a year ago, non-oil import growth of 28.8 per cent was comparable to 29.8 per cent last year. The overall trade deficit during April-September 2005 widened to US $ 20.3 billion from US $ 11.9 billion a year ago, reflecting the hardening of international crude oil prices and more significantly, import demand resulting from a pick-up in domestic industrial activity. Export growth was broad-based at a disaggregated level during April-August, 2005 mainly led by manufactures such as engineering goods, gems and jewellery and chemicals. Within engineering goods, machinery and instruments, transport equipment and manufactures of metals recorded acceleration of growth. Non-oil imports, excluding gold and silver rose by 36.7 per cent during April-August, 2005 led by imports of industrial inputs. Within this category, imports of capital goods increased by 33.5 per cent, while imports of iron and steel surged by 109.9 per cent, reflecting the sustained expansion of domestic demand.