Macroeconomic and Monetary Developments

Third Quarter Review 2005-06

Reserve Bank of India
Mumbai

Contents

I. THE REAL ECONOMY

The robust performance of the Indian economy continued during the second quarter (July-September) of 2005-06. According to the Central Statistical Organisation (CSO), the economy recorded a real GDP growth of 8.0 per cent in the second quarter of 2005-06 maintaining the momentum of growth in the first quarter, and notably higher than that of 6.7 per cent a year ago (Chart 1). Although there was some loss of pace in manufacturing activity during the second quarter from the double-digit growth of the first quarter, it was more or less offset by a stronger growth in the services sector, especially the sub-sector 'financing, insurance, real estate and business services'. Real GDP originating from the 'agricultural and allied activities' benefited from the positive impact of the near normal South-West monsoon. Overall, the economy thus recorded a real GDP growth of 8.1 per cent in the first half of 2005-06, one percentage point higher than a year ago (Table 1).

Against the backdrop of the overall performance of the Indian economy in the first half of 2005-06, this Section presents developments in the Indian economy during 2005-06 so far covering the agricultural sector, industrial production, business and investment expectations and the lead indicators of service sector activity.

Agricultural Situation

The progress of the South-West monsoon season (June-September) 2005 was satisfactory. Although the monsoon was initially weak - till June 22, 2005,

Chart 1 : Real GDP – Quarterly Growth Rates

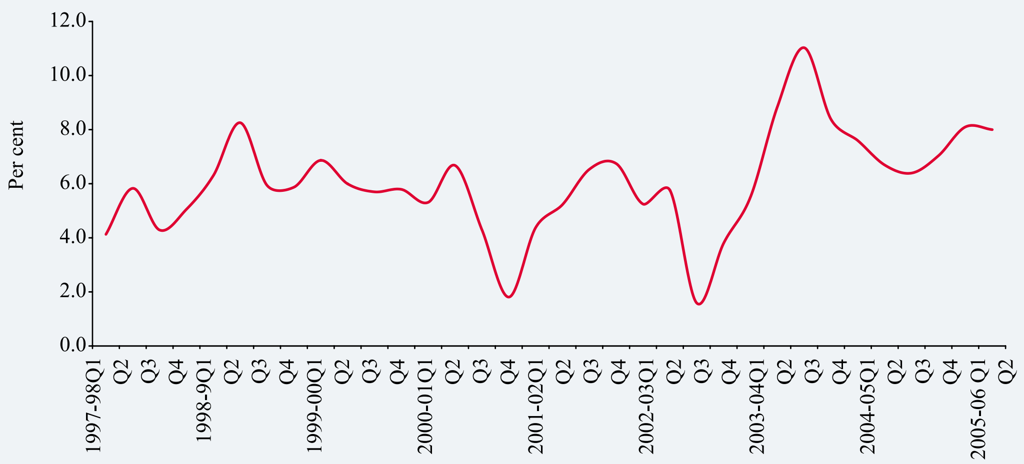


Table 1: Growth Rates of Real GDP

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	2005-06 Q2	2004-05 H1	2005-06 H1
1	2	3	4	5	6	7	8	9	10	11	12
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**	**2.0**	**2.1**	**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**	**7.6**	**8.3**	**8.8**
2.1 Mining and Quarrying	4.7	6.4	4.5	6.9	4.7	4.5	2.5	3.2	-1.1	5.8	1.1
2.2 Manufacturing	7.1	6.9	9.2	7.9	9.6	10.5	8.6	11.3	9.2	8.8	10.2
2.3 Electricity, Gas and Water Supply	5.2	3.7	5.5	6.1	9.1	4.4	2.6	7.9	3.3	7.6	5.6
3. Services	**7.8 (51.4)**	**8.9 (56.7)**	**8.6 (57.6)**	**9.1**	**7.7**	**8.8**	**8.8**	**9.6**	**9.8**	**8.4**	**9.7**
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	12.0	11.9	12.2
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	9.9	6.2	9.1
3.3 Community, Social and Personal services	6.9	5.8	5.9	8.2	3.0	5.6	7.2	6.1	6.7	5.4	6.4
3.4 Construction	5.7	7.0	5.2	5.0	4.6	7.2	4.1	7.9	7.4	4.8	7.6
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**	**8.0**	**7.1**	**8.1**

* : Quick Estimates. # : Revised Estimates. N.A : Not Available.

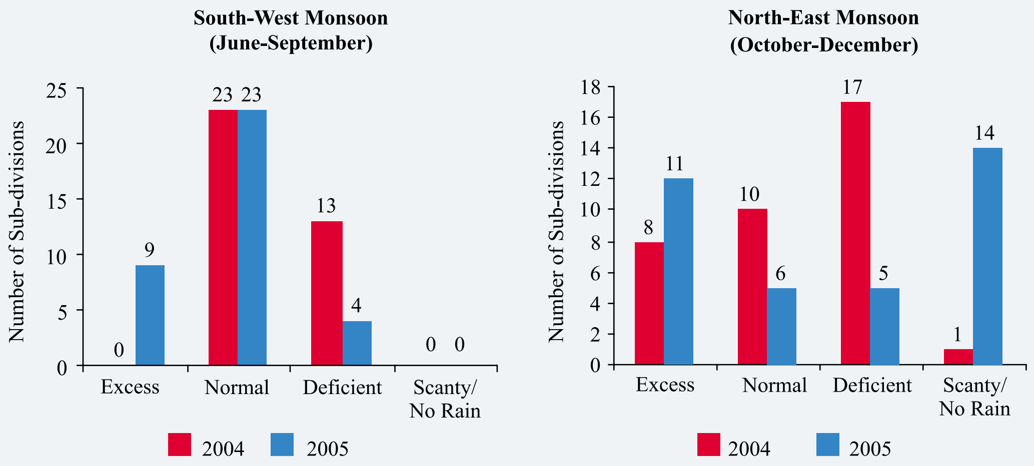
Note : Figures in parentheses denote shares in real GDP.

Source: Central Statistical Organisation.

the cumulative rainfall was 49 per cent below normal – it picked up in the subsequent period and the cumulative rainfall recorded during the season was only one per cent below normal as compared with 13 per cent below normal during 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). At the district level, 72 percent of the total number of districts received excess/normal rainfall, while the rest received deficient rain.

The cumulative rainfall during the North-East Monsoon season (October 1 to December 31, 2005) was 10 per cent above normal as compared with 11 per cent below normal during the corresponding period of the previous year although the distribution of the rainfall was skewed (Chart 2). The total live water storage

Chart 2: Monsoon Conditions



as on January 6, 2005 in the 76 major reservoirs[1] monitored by the Central Water Commission improved to 65 per cent of the Full Reservoir Level (FRL) from 45 per cent a year ago.

A satisfactory monsoon during 2005-06 coupled with adequate water reservoir levels have facilitated improved area coverage under both *kharif* and *rabi* crops. The area under *kharif* crops was 1.2 per cent higher than a year ago, led by increased area under rice, maize, pulses and sugarcane. As regards *rabi* crops, the area coverage as on January 2, 2006 was 1.5 per cent higher than a year ago on account of increased coverage in respect of major crops such as wheat and rapeseed (Table 2).

Agricultural production estimates are available for the *kharif* crop. According to the First Advance Estimates released by the Ministry of Agriculture on September 19, 2005, total *kharif* foodgrains production during 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, maize and pulses. Among the commercial crops, the output of cotton, oilseeds and jute is estimated to decline while that of sugarcane and mesta is expected to show an improvement.

Food Management

The total procurement of rice and wheat during 2005-06 (up to January 3, 2006) at 33.7 million tonnes was 1.6 per cent lower than that in the

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

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

(Million Hectares)

Crop	Normal Area	Area Coverage		
		2004	2005	Variation (2005 over 2004) (Per cent)
1	2	3	4	5
***Kharif* Crops**				
Rice	39.9	35.5	37.1	4.6
Coarse Cereals	22.9	22.5	21.9	-2.5
Of which				
Bajra	9.3	9.1	8.2	-9.4
Jowar	4.6	3.9	3.8	-3.3
Maize	6.0	7.0	7.3	5.2
Pulses	10.6	11.2	11.4	1.4
Oilseeds	15.1	18.0	17.6	-2.6
Of which				
Groundnut	5.5	5.8	5.6	-3.1
Soyabean	6.3	8.0	7.7	-3.1
Sesamum	1.6	2.0	1.9	-6.4
Niger	0.5	0.5	0.4	-23.2
Cotton	8.3	8.6	8.6	0.0
Sugarcane	4.3	3.8	4.1	10.3
All Crops	**101.9**	**100.4**	**101.6**	**1.2**
***Rabi* Crops (As on January 2, 2005)**				
Wheat	26.3	24.1	24.3	0.9
Rice	3.8	0.8	0.8	4.3
Coarse Cereals	6.5	6.8	6.8	-0.1
Of which				
Jowar	5.1	5.2	5.1	-2.5
Maize	0.7	0.7	0.7	-0.8
Barley	0.7	0.8	0.8	1.8
Oilseeds	7.8	9.6	9.9	3.4
Of which				
Rapeseed	5.1	6.7	7.2	6.8
Groundnut	0.8	0.5	0.4	-15.8
Sunflower	1.0	1.2	1.2	1.4
Sesamum	0.2	0.1	0.1	13.6
Linseed	0.5	0.6	0.6	0.5
All Crops	**55.5**	**53.1**	**53.9**	**1.5**

Source: Ministry of Agriculture, Government of India.

corresponding period of the previous year. The total off-take of foodgrains (rice and wheat) during 2005-06 (up to October 31, 2005) at 23.4 million tonnes was marginally higher by 0.2 per cent over the corresponding period of the preceding year, mainly due to a rise in the off-take under the Targeted Public Distribution System (TPDS) and the other welfare schemes (OWS) (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 19.8

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	3.0
Coarse Cereals	26.7	26.4	-1.0
Bajra	8.1	7.8	-3.9
Jowar	4.0	3.9	-3.5
Maize	11.6	12.2	4.9
Total Pulses	5.0	5.0	0.6
Tur	2.6	2.3	-10.5
Other Kharif Pulses	2.4	2.7	12.6
Total Oilseeds	**14.9**	**14.6**	**-2.5**
Groundnut	5.3	5.9	11.4
Soyabean	7.5	6.6	-12.4
Cotton#	**17.0**	**15.9**	**-6.5**
Jute@	**9.6**	**9.2**	**-4.3**
Mesta@	**0.9**	**0.9**	**1.2**
Sugarcane	**232.3**	**257.7**	**10.9**

\# : Million bales of 170 kgs. each. @ : Million bales of 180 kgs. each.
* : Fourth Advance Estimates. ** : First 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.

million tonnes as on November 1, 2005, about 16.5 per cent lower than a year ago. The stocks, however, remained higher than the buffer stock norms (16.2 million tonnes). The decline in stocks was mainly on account of wheat stocks

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	10.7	8.5	9.9	11.2
Cotton #	15.0	13.9	15.0	17.0
Jute and Mesta ##	12.0	11.2	11.8	10.5
Sugarcane	320.0	237.3	270.0	232.3

T : Target A: Achievement $: Fourth Advance Estimates as on September 19, 2005.
\# : Million bales of 170 kgs each. ## : Million bales of 180 kgs each.
Source : Ministry of Agriculture, Government of India.

Table 5: Management of Food Stocks

(Million Tonnes)

Month	Opening Stock of Foodgrains			Procurement of Foodgrains			Foodgrains off-take				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	20.6	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	7.4	0.0	7.4	2.4	0.8	0.0	0.0	23.7	18.1
November	11.0	12.6	23.7	1.9	0.0	1.9	2.4	0.6	0.0	0.0	21.8	
December	11.1	10.7	21.8	3.2	0.0	3.2	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	21.5	16.8
February	14.2	7.3	21.5	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	2.4	0.8	0.0	0.0	28.5	16.2
May	13.0	15.1	28.5	1.2	2.0	3.1	2.5	0.8	0.0	0.0	27.9	
June	11.6	15.7	27.9	0.8	0.1	0.9	2.5	1.5	.0.0	0.0	25.1	
July	10.1	14.5	25.1	0.4	0.0	0.4	2.7	0.8	0.1	0.0	21.4	26.9
August	8.0	13.0	21.4	0.9	0.0	0.9	2.5	0.8	0.1	0.0	18.4	
September	6.4	11.6	18.4	0.4	0.0	0.4	2.6	0.7	0.1	0.0	15.6	
October	4.8	10.3	15.5	7.6	0.0	7.6	2.2	0.5	0.0	0.0	19.8	16.2
November	10.3	9.1	19.8	2.7	0.0	2.7	N.A.	N.A.	N.A.	N.A.	N.A.	
December	N.A.	N.A.	N.A.	3.4	0.0	3.4	N.A.	N.A.	N.A.	N.A.	N.A.	
January*	N.A.	N.A.	N.A.	0.4	0.0	0.4	N.A.	N.A.	N.A.	N.A.	N.A.	

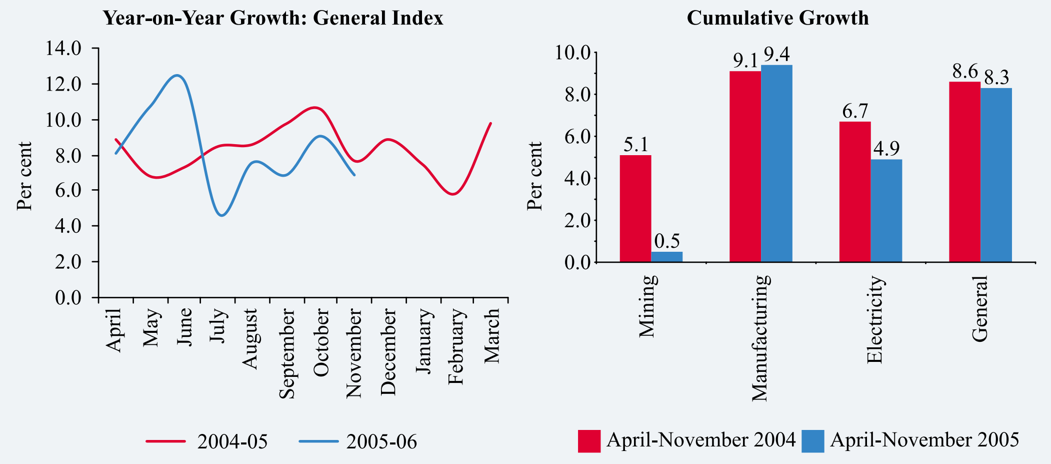
PDS : Public Distribution System. OWS : Other Welfare Schemes. OMS : Open Market Sales.
N.A. : Not Available.
* : Up to January 3, 2006.
Note : Closing stock figures may differ from those arrived at by adding the opening stocks and procurement and deducting offtake, as stocks include coarse grains.
Source : Ministry of Consumer Affairs, Food and Public Distribution, Government of India.

which fell by 28.3 per cent from a year ago levels due to lower procurement. Wheat stocks as on November 1, 2005 were 9.1 million tonnes as compared with the buffer stock norms of 11.0 million tonnes.

Industrial Performance

Manufacturing activity witnessed a strong performance during April-November 2005. Although there was some loss of momentum in July 2005, the cumulative growth during the first eight months at 9.4 per cent was higher than a year ago (9.1 per cent). The mining and electricity sectors, on the other hand, recorded a deceleration. The sharp slowdown in the mining sector may be

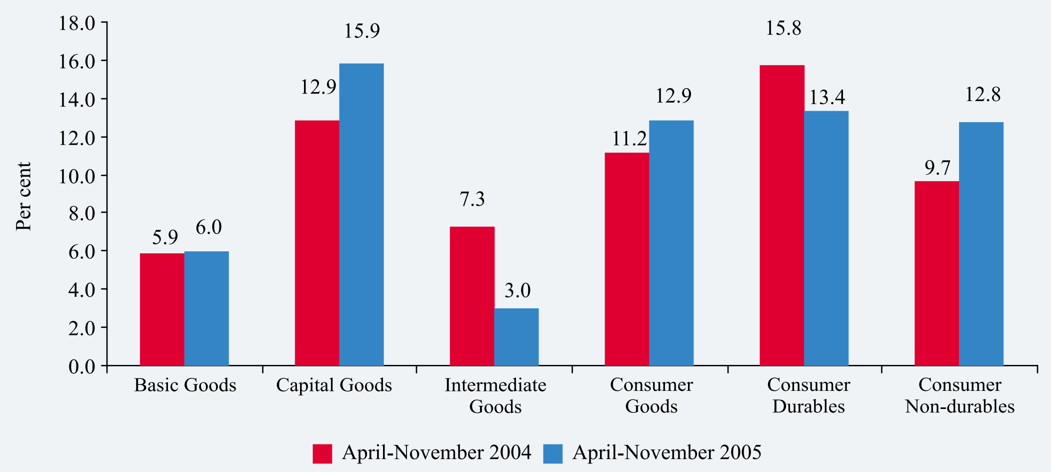
Chart 3: Growth in the Index of Industrial Production



attributable in part to a decline in production of crude oil caused by the break-out of fire in the Mumbai-High oil field in July 2005 and the adverse impact of heavy rainfall on coal mining activities. Lower growth in the electricity sector is attributable to shortage of coal and gas. On the whole, industrial production recorded a growth of 8.3 per cent during April-November 2005 on top of 8.6 per cent in the corresponding period of the preceding year (Chart 3).

Manufacturing activity was broad-based. According to the use-based classification, all major industry groups, except intermediate goods, recorded an acceleration during April-November 2005 (Chart 4). Capital goods recorded

Chart 4: Growth in IIP: Use-Based Classification



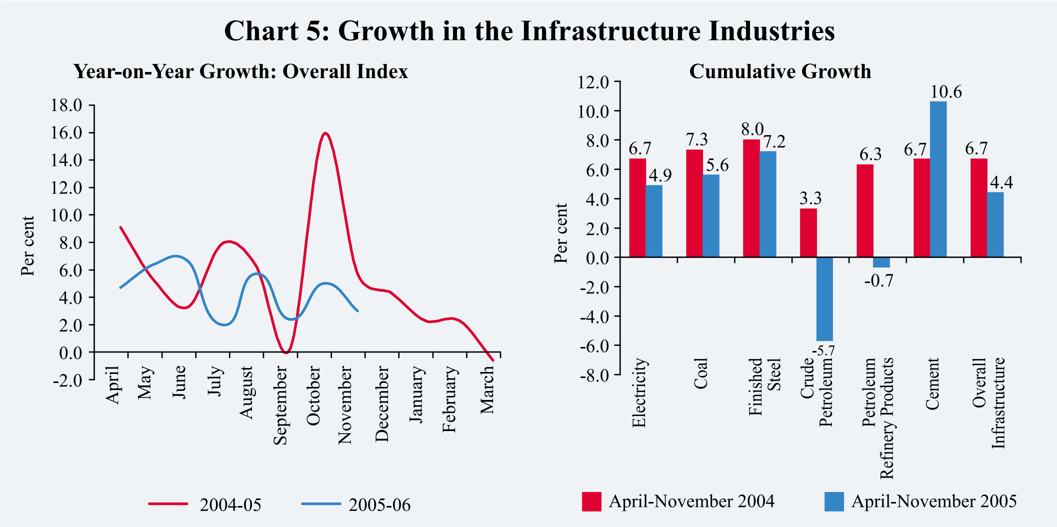
a robust growth of 15.9 per cent - the highest growth during April-November period since 1996-97 (16.5 per cent) - on the back of strong investment demand in the economy. Higher production of textile machinery, industrial machinery, turbines, ship building and repair, material handling equipment, laboratory and scientific instruments, dumpers and boilers propped up the capital goods sector. Consumer goods also recorded a double-digit growth and contributed 48.0 per cent to the overall IIP growth during April-November 2005. While consumer durables sector maintained its high growth, the non-durables segment accelerated due to sugar, milk powder, cotton hosiery cloth, beverages, tobacco and related products. Basic goods recorded a moderate pick-up benefiting from cement, carbon steel, soda ash, caustic soda, salt, sponge iron, aluminium extrusions and aluminium ingots. Intermediate goods sector, however, witnessed a subdued performance largely on account of a slack in petrochemical products, wood and wood products, textile yarns and fibres, finished leather, metal products and parts.

At the two-digit level manufacturing, 13 out of 17 industry groups recorded a positive growth during April-November 2005. Nine industry groups recorded an accelerated growth as compared with eight industry groups in the corresponding period of the previous year. The group 'other manufacturing industries' recorded the highest growth of 23.3 per cent during April-November 2005 followed by textile products (including wearing apparel) at 21.6 per cent (Table 6).

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

Acceleration in Growth	Deceleration in Growth	Negative Growth
1. Other manufacturing industries (23.3)	1. Chemicals and chemical products (12.0)	1. Wool, silk and man-made fibre textiles (-1.0)
2. Textile products (including wearing apparels) (21.6)	2. Machinery and equipment other than transport equipment (10.1)	2. Metal products and parts (except machinery and equipment) (-2.1)
3. Beverages, tobacco and related products (17.0)	3. Rubber, plastic, petroleum and coal products (2.7)	3. Wood and wood products, furniture and fixtures (-3.5)
4. Basic metal and alloy industries (15.3)	4. Leather and leather and fur products (1.4)	4. Food products (-4.3)
5. Transport equipment and parts (12.5)		
6. Cotton textiles (11.7)		
7. Non-metallic mineral products (8.2)		
8. Paper and paper products (5.8)		
9. Jute and other vegetable fibre textiles (2.6)		

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



Infrastructure

During April-November 2005, the infrastructure sector continued to remain subdued on account of a decline in crude petroleum and petroleum refinery products as well as a deceleration in growth in other infrastructure industries barring cement (Chart 5). Cement production benefited from the strong growth in domestic demand as well as high exports. Steel production was upheld by domestic demand, although growth was slightly lower than that recorded in last year. Heavy rainfall during the monsoon season pulled down growth in the coal sector. Growth in the electricity sector decelerated on account of inadequate availability of coal and gas. Crude oil recorded negative growth on account of disruption in production activity owing to break-out of fire in Mumbai High oilfield on July 27, 2005.

Business Expectations Surveys

Business expectation surveys suggest that the current phase of industrial activity is likely to continue in the near future (Table 7). FICCI's latest business

Table 7: Business Expectations Surveys

Agency	Business Expectations		Growth over previous round (Per cent)
	Expectation for	Index	
1	2	3	4
Dun & Bradstreet	October-December 2005	Business Optimism Index	7.1
NCAER	October 2005-March 2006	Business Confidence Index	1.3
FICCI	October 2005-March 2006	Business Confidence Index	2.3
CII	September 2005-March 2006	Business Confidence Index	1.5
RBI	January-March 2006	Business Expectations Index	2.4

confidence survey indicates that industrial activity is expected to record a strong growth in the remaining part of the fiscal year. According to the survey, 70 per cent of the respondents reported capacity utilisation of over 75 per cent reflecting strong demand conditions in the economy. Demand conditions are expected to further strengthen with 83 per cent of the respondents expecting 'higher to much higher sales' and 51 per cent of respondents expecting 'higher to much higher investment'. 34 per cent of the participating companies are planning to add to their workforce. Rising cost of raw materials was, however, viewed as a constraint by a majority (76 per cent) of the respondents and 29 per cent respondents foresaw an increase in their selling prices over the next six months. Similar findings emerge from the latest survey of the Confederation of Indian Industry (CII). The survey results for the second half of 2005-06 show that: (i) 80 per cent of the respondents plan to increase investment; (ii) 60 per cent expect capacity utilisation to be up to 100 per cent and another 19 per cent expect capacity utilisation to exceed 100 per cent; and (iii) 84 per cent expect employment to increase. According to the survey, the confidence index was significantly higher for non-manufacturing firms compared to the manufacturing firms.

According to the Reserve Bank's latest Industrial Outlook Survey, the Business Expectations Index for January-March 2006 quarter increased by 2.4 per cent over the previous quarter (Chart 6). The expectations index based on the assessment for October-December 2005 was robust showing a rise of 8.2 per cent over the previous quarter, the highest since the inception of the survey.

Survey results indicate that employment, selling prices, imports and profit margins are expected to improve during the quarter January-March 2006 *vis-à-vis* October-December 2005. On the other hand, the overall business situation,

Chart 6: Reserve Bank's Industrial Outlook Survey: Business Expectations Index

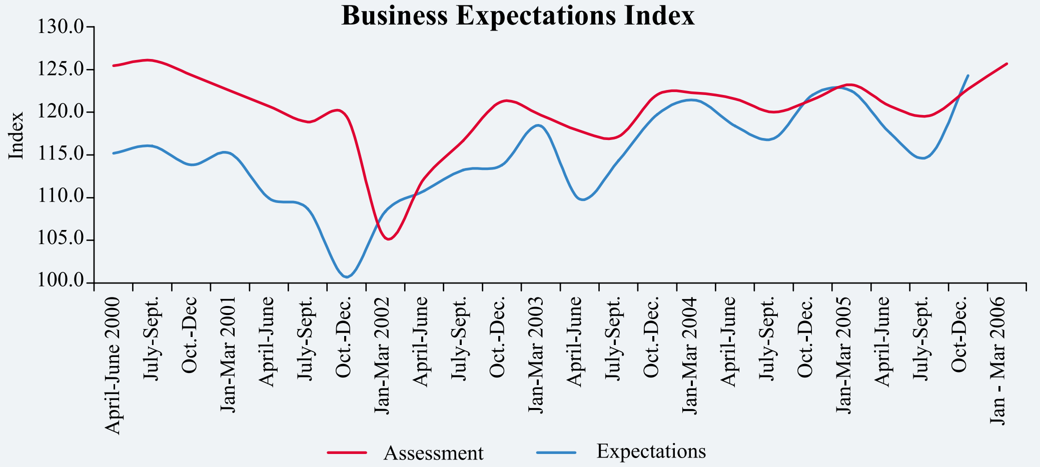


Table 8: Net Response on 'A Quarter Ahead' Expectations about Industrial Performance

(Per cent)

	Parameter	Response	Jan-March 2005 (987)	Apr-June 2005 (987)	July-Sept. 2005 (816)	Oct-Dec. 2005 (961)	Jan-March 2006 (934)
	1	2	3	4	5	6	7
1	Overall business situation	Better	47.4	44.3	45.5	51.3	49.8
2	Financial situation	Better	37.5	36.7	36.7	42.3	40.7
3	Working capital finance requirement	Increase	29.2	27.2	28.8	32.7	31.9
4	Availability of finance	Improve	31.3	30.8	30.7	34.1	34.1
5	Production	Increase	45.9	38.7	40.7	46.9	46.3
6	Order books	Increase	42.2	37.4	39.6	43.7	41.0
7	Cost of raw material	Decrease	-41.8	-36.7	-43.6	-30.0	-35.9
8	Inventory of raw material	Below average	-7.4	-4.3	-4.2	-6.9	-6.8
9	Inventory of finished goods	Below average	-5.2	-3.1	-4.2	-3.3	-4.7
10	Capacity utilisation	Increase	31.3	27.7	25.4	31.1	29.6
11	Level of capacity utilisation	Above normal	12.9	8.1	7.6	10.9	11.4
12	Assessment of the production capacity	More than adequate	6.6	5.7	5.3	5.0	4.9
13	Employment in the company	Increase	8.0	7.7	7.8	12.7	13.3
14	Exports, if applicable	Increase	31.5	30.2	32.5	33.3	31.8
15	Imports, if any	Increase	22.2	20.3	23.7	19.2	20.8
16	Selling prices are expected to	Increase	8.6	11.0	13.3	7.8	10.8
17	If increase expected in selling prices	Increase at lower rate	8.2	13.5	14.0	16.6	16.3
18	Profit margin	Increase	5.6	6.3	7.1	9.6	12.6

Note : 1. Figures in parentheses represent number of companies covered in the Survey.

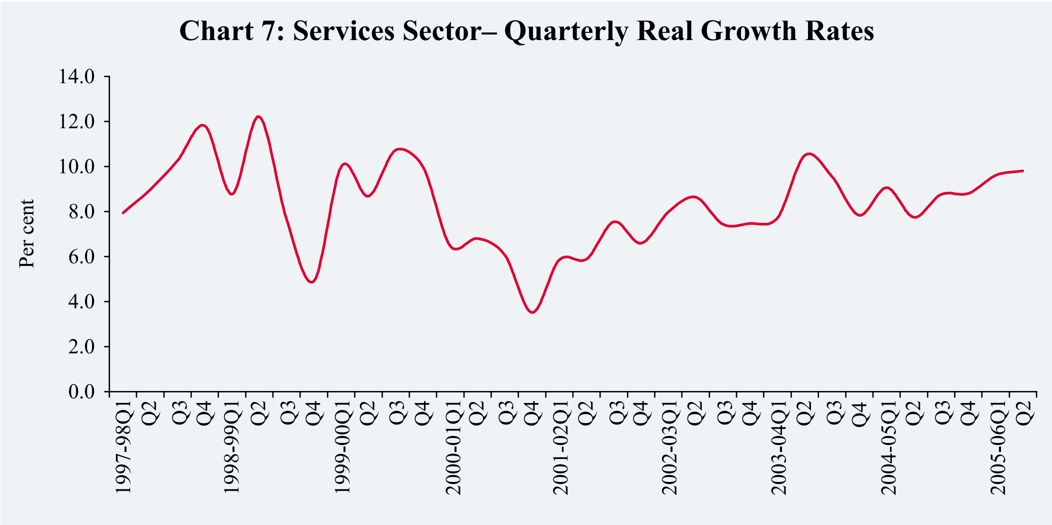
2. 'Net response' is measured as the per cent share differential between the companies reporting 'optimistic' (positive) and 'pessimistic' (negative) responses; responses indicating status quo (no change) are not reckoned. Higher 'net response' indicates higher level of confidence and vice versa.

financial situation, production, order books, capacity utilisation, and exports are expected to show some decline over the previous quarter. However, the expectations of all these indicators for January-March 2006 are better than that in the corresponding quarter of 2005 (Table 8).

Services Sector

Services sector growth accelerated to 9.8 per cent during the second quarter of 2005-06 from 9.6 per cent in the previous quarter and 7.7 per cent a year ago, led by its major constituent sectors (Chart 7 and Table 1).

Construction activity was buoyed up by rise in demand for housing. Rise in domestic and international tourism, both business as well as leisure, aided growth of the hotel industry. Higher revenue earning freight traffic of railways, civil aviation and port traffic reflecting increased economic activity propped up the transport sector. Robust growth in the cellular subscriber base and steady growth in



broadband connections supported the strong growth in the communication sector. Sustained growth in bank deposits and non-food credit as well as increased exports of information technology enabled services boosted the sub-sector 'financing, insurance, real estate and business services'. Community, social and personal services increased due to increase in revenue expenditure on 'other economic services', 'defence revenue expenditure', plan revenue expenditure of the Central Government on 'social services', and pension payments. Latest available information on the major indicators of services sector indicates continued buoyancy in 2005-06 (Table 9).

Table 9: Indicators of Service Sector Activity

(Growth rates in per cent)

Sub-sector	April-October 2004	April-October 2005
1	2	3
Tourist arrivals	24.8	12.7
Commercial vehicles production (April-November)	30.3	15.3
Railway revenue earning freight traffic	7.7	9.5
New cell phone connections	29.6	38.4
Cargo handled at major ports	10.7	11.7
Civil aviation		
a) Export cargo handled	11.9	15.5
b) Import cargo handled	32.5	12.3
c) Passengers handled at international terminals	15.3	12.8
d) Passengers handled at domestic terminals	25.1	22.5
Roads: Upgradation of Highways	4.6	-5.9
Cement (April-November)	6.7	10.6
Steel (April-November)	8.0	7.2
Aggregate deposits (April-December)	7.5	14.0
Non-food credit (April-December)	18.2	22.3
Central Government expenditure (April-November)	-5.6	10.8

The normal South-West monsoon, the sustained growth of the manufacturing, the buoyancy in services and the positive business confidence and expectations have further brightened growth prospects for 2005-06 (Table 10).

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

Agency	Growth Projections for 2005-06 (Per cent)				Month of Projections
	Overall Growth	Agriculture	Industry	Services	
1	2	3	4	5	6
ADB	6.9	4.4	6.7	7.7	September, 2005
BIS	7.1				June, 2005
CII	a) 7.2	3.0	8.1	8.3	May, 2005
	b) 7.3	3.2			October, 2005
CMIE	a) 6.0	(-)0.7	8.5	7.5	June 2005
	b) 6.8	3.0	8.5	7.5	August, 2005
	c) 7.6	3.0	8.1	9.2	December, 2005
CRISIL	a) 7.0	3.0	7.0	8.6	May, 2005
	b) 7.0	2.5	7.4	8.5	September, 2005
NCAER	a) 7.2	3.30	7.61	8.55	May, 2005
	b) 7.05-7.1	2.5	7.54	8.55	July, 2005
	c) 7.6	3.4	8.0	9.0	November, 2005
IMF	a) 6.7				April, 2005
	b) 7.1				September, 2005
Ministry of Finance	a) 7.0	3.0	Expected to perform well	Expected to perform well	May, 2005
	b) Over 7.0	3.0-3.5	8.5-10.0 per cent growth in industrial and services sectors		December, 2005
Reserve Bank of	a) Around 7.0	Growth in agriculture around 3.0 per cent; industry and services expected to maintain their current growth momentum			April, 2005
	b) 7.0-7.5	Pick-up in agricultural output and in the momentum in industrial and services sectors			October, 2005

II. FISCAL SITUATION

Combined Government Finances: 2005-06

Key fiscal ratios of combined finances are budgeted to improve 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.

Centre's Fiscal Situation

The available information on finances of the Central Government for the first eight months of 2005-06 (April-November) indicates an improvement in key fiscal variables due to a continued buoyancy in the tax collections and containment of growth in non-Plan expenditure. Although revenue deficit, as per cent of budget estimates, was lower in April-November 2005 than a year ago, fiscal deficit and primary deficit were higher than a year ago (Table 12). Adjusting for debt swap receipts of Rs. 32,066 crore in April-November 2004, fiscal deficit and primary deficit, as proportion to budget estimates, were, however, lower in April-November 2005 than a year ago. The surplus cash balance with the Reserve Bank has been higher during 2005-06 so far, which is expected to provide flexibility to the Central Government in managing its expenditure flows for the remaining part of the year.

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 for years 2003-04 onwards.

Table 12: Central Government Finances during April-November 2005

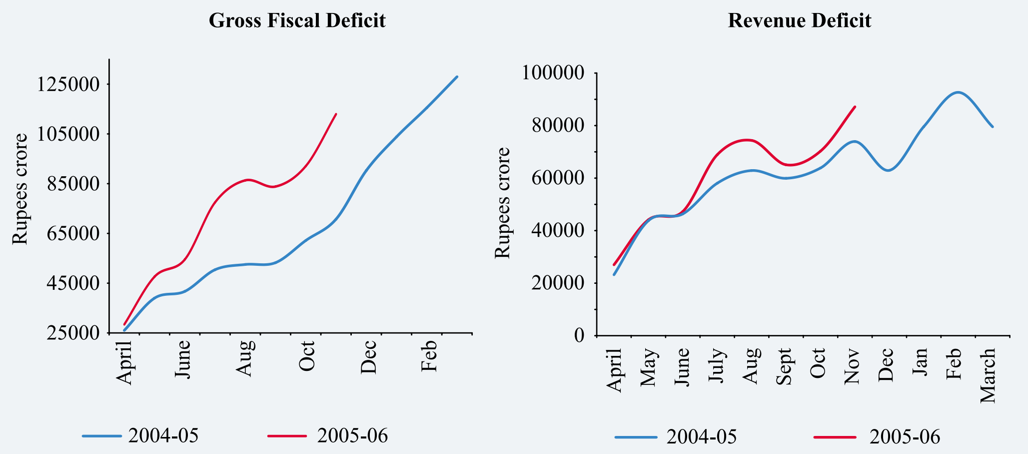
(Rupees crore)

Items	2005-06 (Budget Estimates)	April-November 2004	April-November 2005	Per cent of Budget Estimates April-November 2004	Per cent of Budget Estimates April-November 2005
1	2	3	4	5	6
1. Revenue Receipts (i + ii)	3,51,200	1,49,061	1,73,703	48.2	49.5
i) Tax Revenue	2,73,466	1,06,669	1,30,095	45.6	47.6
ii) Non-tax Revenue	77,734	42,392	43,608	56.2	56.1
2. Non-debt Capital Receipts	12,000	44,625	6,370	143.5	53.1
3. Non-Plan Expenditure	3,70,847	1,95,511	2,10,638	58.8	56.8
of which:					
i) Interest Payments	1,33,945	74,625	75,526	57.6	56.4
ii) Defence	48,625	24,740	27,072	56.9	55.7
iii) Subsidies	46,358	30,803	31,149	73.0	67.2
4. Plan Expenditure	1,43,497	68,892	82,384	47.3	57.4
5. Revenue Expenditure	4,46,512	2,23,009	2,60,884	57.9	58.4
6. Capital Expenditure	67,832	41,394	32,138	44.8	47.4
7. Total Expenditure	5,14,344	2,64,403	2,93,022	55.3	57.0
8. Revenue Deficit	95,312	73,948	87,181	97.1	91.5
	(2.7)				
9. Gross Fiscal Deficit	1,51,144	70,717	1,12,949	51.5	74.7
	(4.3)				
10. Gross Primary Deficit	17,199	-3,908	37,423	-49.4	217.6
	(0.5)				

Note : Figures in parentheses are per cent to GDP.
Source : Controller General of Accounts, Ministry of Finance.

Tax revenue of the Central Government during April- November 2005, as per cent of BE, was higher than a year ago on account of higher collections under corporation tax, income tax, customs duties and service tax. New taxes *viz.*, fringe benefit tax, securities transaction tax and banking cash transaction tax have also contributed to the buoyancy in tax revenue during the current year. The growth in non-tax revenue was, however, moderate on account of lower interest receipts. Revenue expenditure, as per cent of BE, was marginally higher than a year ago. Despite containment of non-Plan expenditure on subsidies and interest payments, revenue expenditure was higher on account of increase in Plan expenditure. Capital expenditure during the period under review declined due to withdrawal of loan support to States' Plans and lower defence capital expenditure. Gross fiscal deficit (GFD) during April-November 2005 was higher than a year ago, essentially reflecting the impact of discontinuation of the Debt Swap Scheme (DSS) (Chart 8). Adjusted for DSS transactions in the previous year, growth in fiscal deficit at 9.9 per cent was comparable to 9.7 per cent a year ago.

Chart 8: Key Deficit Indicators of the Centre



Financing of the Union Budget

During the first eight months of the fiscal year 2005-06, market borrowings financed the major portion of the GFD. In addition to market borrowings, large recourse to draw down of cash balances enabled the Centre to finance its GFD and bridge the gap in the Public Account.

During 2005-06 (up to January 18, 2006), the actual issuances of dated securities at Rs.1,15,000 crore was lower than Rs.1,27,000 crore scheduled in the calendar for 2005-06 (Table 13). This was on account of (i) 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 (ii) rejection of bids for an issue of Rs.6,000 crore on October 6, 2005 and (iii) cancellation of the auction of dated securities scheduled for October 18-25, 2005 for an amount of Rs.4,000 crore based on review of the current borrowing requirements of the Government of India. Gross and net market borrowings (excluding issuances under market stabilisation scheme) of the Centre (up to January 18, 2006) amounted to 82.6 per cent and 80.0 per cent of the BE as compared with 63.7 per cent and 45.0 per cent, respectively, a year ago.

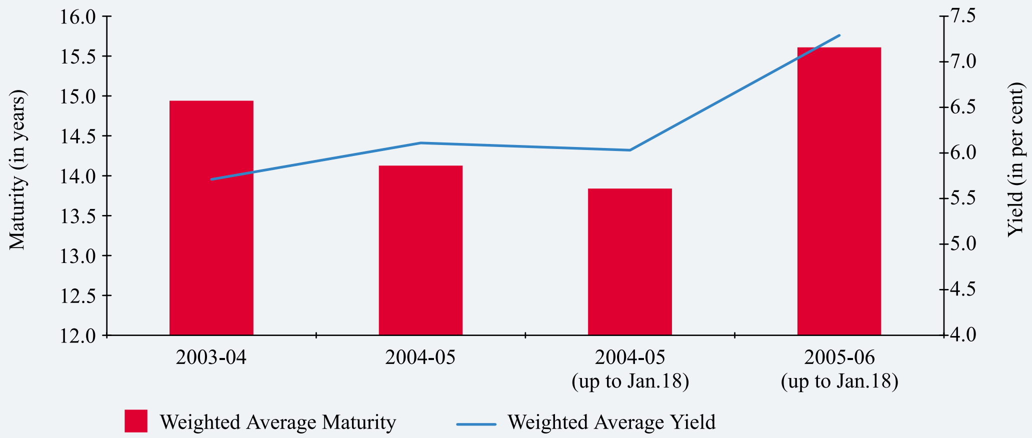
The weighted average yield of the dated securities issued during 2005-06 (up to January 18, 2006) increased to 7.29 per cent from 6.03 per cent during the corresponding period of 2004-05. The weighted average maturity of dated securities of the Central Government over the same period was higher at 15.61 years than 13.84 years in the corresponding period of the preceding year (Chart 9). The secondary market yield on 10-year Central Government securities has increased to 7.1 per cent during 2005-06 so far (up to January 18, 2006) from 6.0 per cent during the corresponding period of the previous year. In this context, it may be noted

Table 13: Central Government Securities Issued during 2005-06

Date of Auction	Notified Amount (Rupees 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 8, 2005	3,000	29.92	7.66
November 9, 2005	5,000	11.44	7.33
November 9, 2005	3,000	29.83	7.73
November 25, 2005	5,000	16.47	7.43
December 7, 2005	5,000	11.11	7.24
December 7, 2005	3,000	29.76	7.55
January 9, 2006	6,000	5.48	6.70
January 9, 2006	4,000	29.66	7.43

that the spread between 15-year and 10-year yields in the secondary market narrowed to 30 basis points during April-December 2005 from 45 basis points during April-December 2004. Similarly, the spread between 20-year and 15-year yields narrowed to 9 basis points from 15 basis points over the same period.

Chart 9: Weighted Average Yield and Maturity of Primary Auctions of the Dated Securities of the Centre



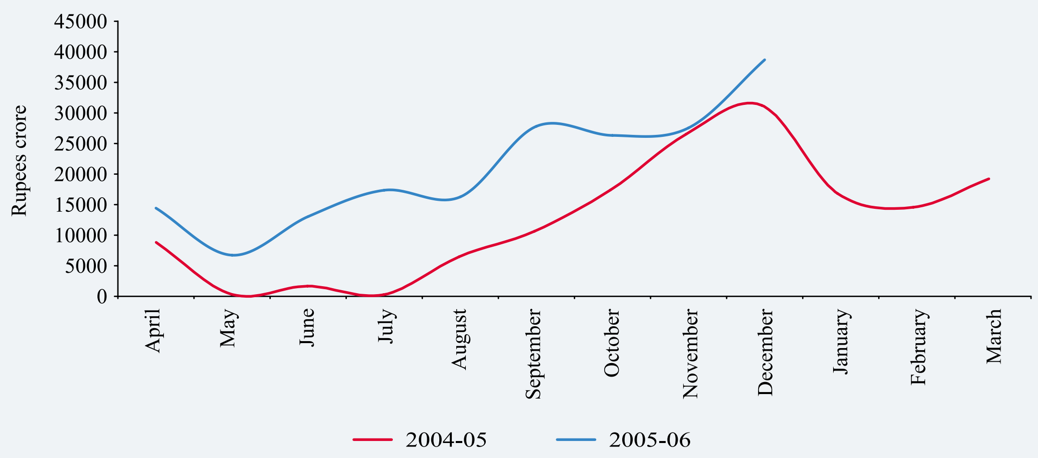
The limits on Centre's Ways and Means Advances (WMA) from the Reserve Bank continued at Rs.10,000 crore for the first half (April-September) and Rs. 6,000 crore for the second half (October-March) of 2005-06. Reflecting its comfortable liquidity position, the Centre has availed WMA only twice (May 3 and June 4, 2005) during 2005-06 so far (up to January 18, 2006). The Centre has maintained higher surplus cash balances with the Reserve Bank during 2005-06 so far (up to January 14, 2006) (daily average of Rs.21,398 crore) than that in the corresponding period of 2004-05 (Rs.11,171 crore) (Chart 10).

Assessment of Central Government Finances (April-September, 2005): Mid-Year Review by Government of India

The Central Government released the "Mid-Year Review" of the economy for the first half of 2005-06 on December 9, 2005 as required under the Fiscal Responsibility and Budget Management (FRBM) Act, 2003. The Central Government finances during this period showed improvement as the key deficit indicators, as per cent of BE, declined over their levels (adjusted for debt swap transactions) a year ago due to buoyant tax collections. Nonetheless, the Government expressed concern over sluggish growth in excise collections despite impressive growth in the manufacturing sector. Revenue expenditure, as per cent of BE, was lower than a year ago whereas capital expenditure was higher on account of post-budget decision to extend external loans through the budget.

Despite the improvement over the corresponding period of the previous year, the Central Government could not meet any of the half-yearly targets (in respect of non-debt receipts, fiscal deficit and revenue deficit) set under the

Chart 10: Daily Average Cash Balances of the Central Government



FRBM Rules, 2004. In such an event, the Central Government is required to take measures towards revenue augmentation and expenditure containment. The Mid-Year Review, however, points out that mid-year targets need to be evaluated in the light of structural changes that have taken place in revenue and expenditure flows in recent years. Decline in the share of indirect taxes, which are collected more frequently, implied lower realisation of the revenue in first half of the year. Furthermore, measures taken to spread expenditure flows evenly through financial year to avoid the last quarter rush of expenditure implied incurrence of higher expenditure in the first half of the year than in the past. Thus, these shifts in the revenue and expenditure flows need to be factored in while making an assessment of the mid-year targets. Nevertheless, the Government has initiated measures to tone up tax administration and improve indirect tax collections particularly excise collections. To improve expenditure management the Government has already presented the first 'Outcome Budget' to improve the quality of expenditure with a focus on 'outcomes' rather than 'outlays'. Furthermore, the Government has issued fresh guidelines to moderate non-Plan expenditure. The pressure on expenditure is, however, anticipated to emanate from i) increased requirement of Government-funded supply of foodgrains for employment guarantee programme and *Sampoorana Gramin Rozgar Yojna* and ii) provisioning for Externally Aided Projects (EAPs) under State Plans due to post-budget decision to continue routing them through the Consolidated Fund of India. Notwithstanding such pressures, the Government expects to achieve the budgeted targets.

State Finances

Financing of the States' Budgets

The 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.1,734 crore, the gross allocation amounts to Rs.24,121 crore. State budgets 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 January 18, 2006), the States have raised an amount of Rs.15,702 crore *i.e.,* 65.1 per cent of their gross allocation for 2005-06 (Table 14).

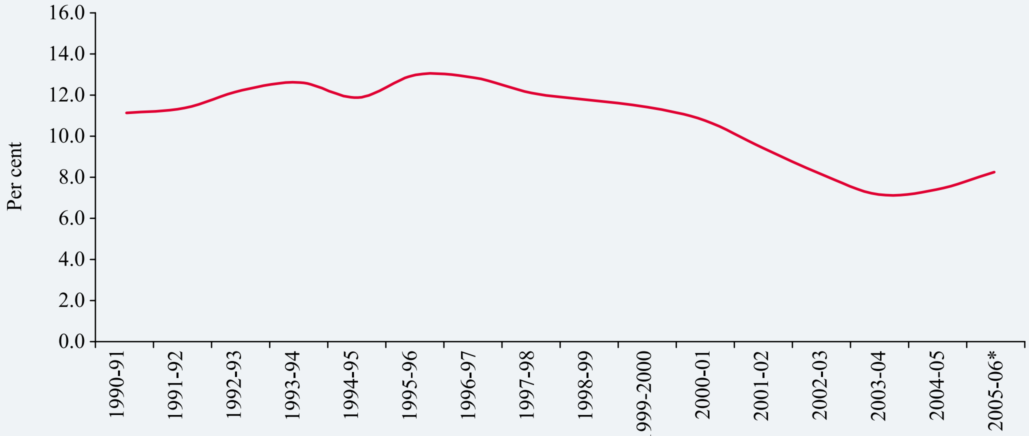
Table 14: Market Borrowings of the State Governments during 2005-06
(as on January 18, 2006)

Items	Date	Cut-off Rate (Per cent)	Tenor (Years)	Amount Raised (Rupees 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
iii. Third Tranche	January 16, 2006	7.61	10	700
Total (i to iii)				**11,185**
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
viii. Fifth	November 17, 2005	7.34	10	375
ix. Sixth	December 15, 2005	7.33	10	361
Total (i to ix)				**4,517**
Grand Total (A+B)				**15,702**

The weighted average interest rate of market loans during 2005-06 (up to January 18, 2006) firmed up to 7.61 per cent from 6.38 per cent in the comparable period of 2004-05 (Chart 11).

The weekly average utilisation of WMA and overdraft by the States during 2005-06 (up to end-December 2005) amounted to Rs.639 crore, significantly lower than that of Rs.3,107 crore in the corresponding period of the previous year

Chart 11: Weighted Average Interest Rate on State Government Market Borrowings



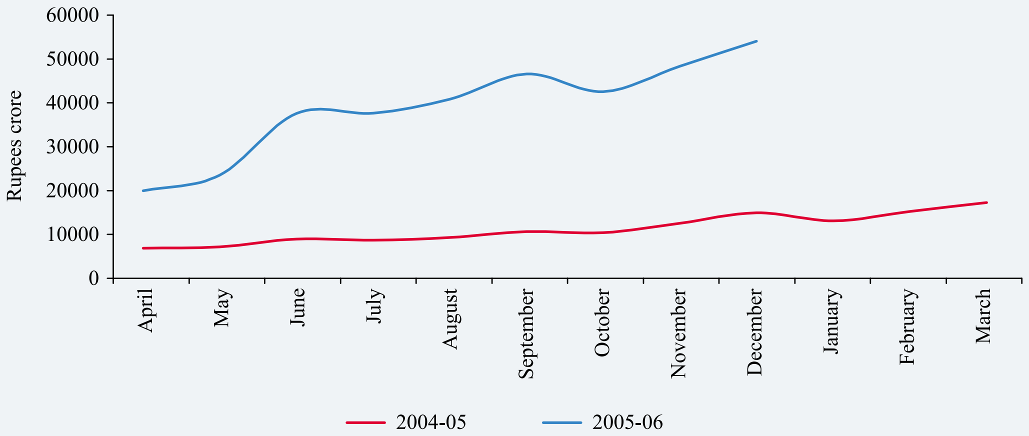
* : Up to January 18, 2006

Chart 12: Utilisation of WMA and Overdraft by State Governments (Weekly Average)

(Chart 12). Nine States have resorted to overdraft during 2005-06 so far (up to January 18, 2006) as compared with 13 States during the corresponding period of the previous year.

The improvement in the overall cash position of the States was also reflected in a spurt in their investments in 14-day Intermediate Treasury Bills. These investments have averaged Rs. 32,789 crore per month during 2005-06 so far (up to end-December 2005), substantially higher than that of Rs.9,081 crore in the corresponding period of the previous year (Chart 13).

Chart 13: Investments in 14-day Intermediate Treasury Bills by State Governments (Weekly Average)



III. MONETARY AND LIQUIDITY CONDITIONS

Monetary Survey

Monetary and liquidity conditions have generally remained comfortable during 2005-06 so far despite a sustained pick-up in credit demand from the commercial sector to support the buoyant real economic activity. During December 2005, however, the banking system faced some liquidity pressures in the context of the redemption of India Millennium Deposits (IMDs). The Reserve Bank accordingly injected liquidity through repo operations. With the smooth redemption of the IMDs and other liquidity management measures, liquidity conditions eased during the first week of January 2006. Expansion of reserve money, which was higher throughout the first two quarters of the year, exhibited a deceleration during the third quarter. The rising demand for commercial credit was met by banks by restricting their incremental investments in Government papers (Table 15).

Table 15: Monetary Indicators

(Amount in Rupees crore)

Item	Outstanding as on January 6, 2006	Variation (year-on-year) 2004-05 Amount	2004-05 Per cent	2005-06 Amount	2005-06 Per cent
1	2	3	4	5	6
I. Reserve Money*	5,53,861	68,256	17.3	91,517	19.8
II. Broad Money (M_3)	25,34,422	2,58,791	13.5	3,48,327	15.9
a) Currency with the Public	3,97,856	39,146	12.8	52,861	15.3
b) Aggregate Deposits	21,31,915	2,18,413	13.5	2,95,362	16.1
i) Demand Deposits	3,39,271	42,122	18.9	74,627	28.2
ii) Time Deposits	17,92,644	1,76,291	12.7	2,20,735	14.0
of which: Non-Resident Foreign Currency Deposits	54,441	-184	-0.2	-20,914	-27.8
III. NM_3	25,58,116	2,67,575	14.3	3,78,013	17.3
of which: Call Term Funding from Financial Institutions	80,831	7,217	31.5	15,537	23.8
IV. a) L_1	26,28,182	2,73,254	14.3	4,03,771	18.5
of which: Postal Deposits	99,771	17,136	25.8	16,124	19.3
b) L_2	26,29,833	2,68,639	14.0	4,03,525	18.4
of which: FI Deposits	1,651	-4,615	-70.9	-246	-13.0
c) L_3	26,49,673	2,68,236	13.8	4,03,467	18.3
of which: NBFC Deposits	19,840	-403	-2.0	-58	-0.3
V. Major Sources of Broad Money					
a) Net Bank Credit to the Government (i+ii)	7,80,238	16,484	2.3	21,327	2.8
i) Net Reserve Bank Credit to Government	18,941	-50,426		21,206	
of which: to the Centre	18,925	-44,144		22,611	
ii) Other Banks' Credit to Government	7,61,298	66,911	9.8	121	0.0
b) Bank Credit to Commercial Sector	15,41,796	2,13,855	22.1	3,26,740	26.9
c) Net Foreign Exchange Assets of Banking Sector	6,55,339	95,498	19.0	56,534	9.4
Memo items					
Scheduled Commercial Banks' Aggregate Deposits	19,39,640	2,10,124	14.5	2,81,617	17.0
Scheduled Commercial Banks' Non-food Credit	13,13,770	2,02,585	26.6	3,18,121	32.0

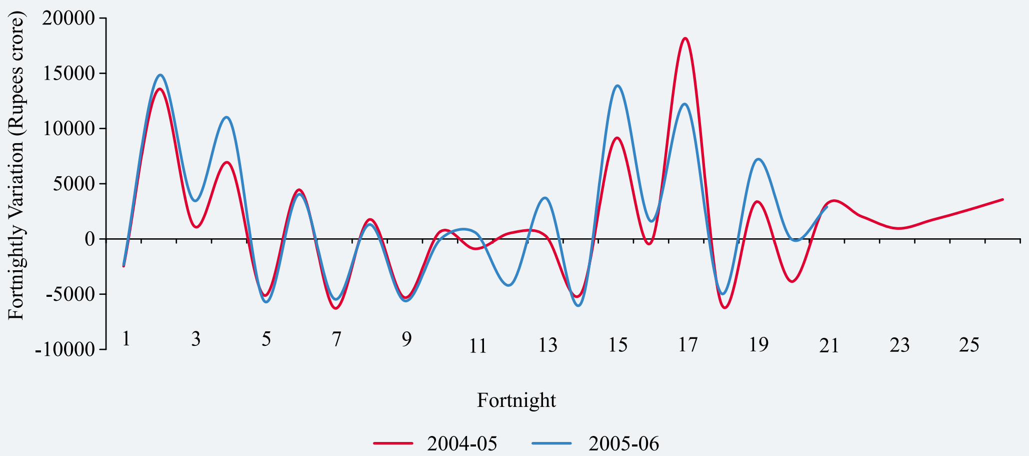
* : Data pertain to January 13, 2006. FIs : Financial Institutions. NBFCs: Non-banking Financial Companies.

Note : 1. Data are provisional and reflect the redemption of IMDs on December 29, 2005. Variation for select aggregates are adjusted for the effect of conversion of a non-banking entity into a banking entity effective October 11, 2004.
2. Figures for item IV pertain to December 2005.

Higher appetite of non-bank institutions for Government papers further paved the way for meeting the augmented demand for commercial credit. As a result of these factors and also due to base effects, the broad money (M_3) growth has been above the indicative trajectory of 14.5 per cent projected in the Annual Policy Statement (April 2005). M_3 growth, however, decelerated from 17.9 per cent on December 23, 2005 to 15.9 per cent on January 6, 2006 reflecting the impact of redemption of IMDs. Expansion in the residency-based new monetary aggregate (NM_3) – which excludes foreign currency non-resident deposits like IMDs – was higher than M_3.

The year-on-year growth in demand for currency as on January 6, 2006 was higher than a year ago. Currency demand exhibited the usual intra-year seasonal pattern, typically increasing during festival seasons and the initial part of the month (Chart 14).

Chart 14: Currency with the Public



Demand deposits continued with their rapid growth for the second successive year mirroring the sustained pick-up in non-food credit and a buoyant primary capital market, with funds getting temporarily parked in demand deposits (Table 16). With the continued surge in demand deposits, some rise can be observed in weighted contribution of demand deposits in growth of broad money (Chart 15).

Year-on-year (y-o-y) growth in time deposits of scheduled commercial banks as on January 6, 2006 at 14.8 per cent was higher than that recorded a year ago (13.7 per cent; net of the conversion effect) partly reflecting the base effects. Deceleration in time deposits during the fortnight ended January 6, 2006, however, reflected the impact of IMD redemption. Mobilisation under small savings schemes decelerated to 17.7 per cent by end-November 2005 from a peak of 23.3 per cent

Table 16: Monetary Aggregates - Variations

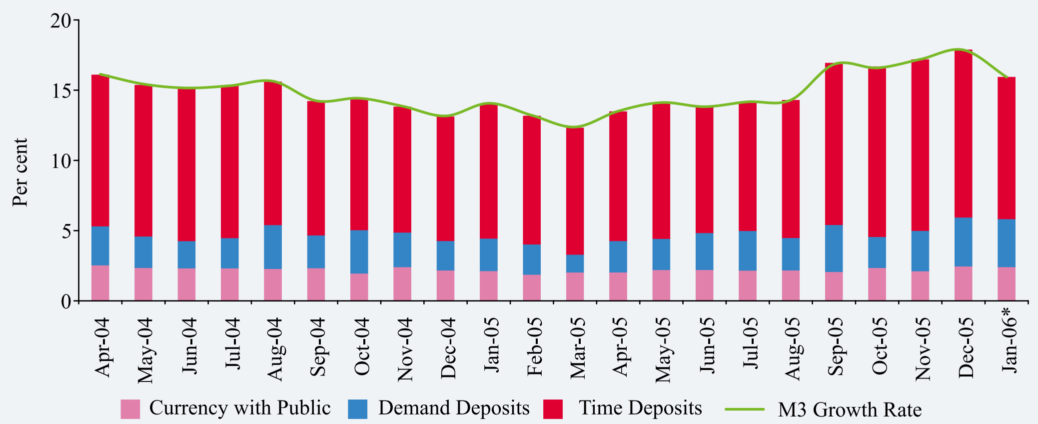
(Rupees crore)

Item	2004-05	2004-05				2005-06		
		Q1	Q2	Q3	Q4	Q1	Q2	Q3
1	2	3	4	5	6	7	8	9
M_3 (=1+2+3 = 4+5+6+7-8)	2,48,262	69,831	16,999	53,458	1,07,975	1,08,489	1,08,139	58,719
Components								
1. Currency with the Public	40,797	14,540	-3,098	15,422	13,933	19,626	-10,248	29,629
2. Aggregate Deposits with Banks	2,06,106	56,754	19,342	37,725	92,284	90,885	1,17,616	29,826
2.1 Demand Deposits with Banks	25,391	-14,038	2,094	15,721	21,614	15,150	32,907	5,004
2.2 Time Deposits with Banks	1,80,716	70,792	17,248	22,004	70,671	75,735	84,709	24,822
3. 'Other' Deposits with RBI	1,359	-1,463	755	310	1,757	-2,021	771	-736
Sources								
4. Net Bank Credit to Govt. Sector	15,002	12,986	-11,798	-4,524	18,338	10,673	-14,031	-684
4.1 RBI's Net Bank Credit to Govt. Sector	-62,882	-34,143	-6,179	184	-22,744	9,275	-25,251	19,879
4.1.1 RBI's Net Credit to Central Govt.	-60,177	-30,029	-4,499	203	-25,852	14,600	-25,251	19,812
4.2 Other Bank Credit to Govt. Sector	77,884	47,129	-5,619	-4,708	41,082	1,397	11,220	-20,563
5. Bank Credit to Commercial Sector	2,64,389	38,057	40,093	107,789	78,451	58,740	1,01,219	80,634
6. Net Foreign Exchange Assets of Banking Sector	1,22,669	49,206	-1,335	32,891	41,907	-13,378	24,062	23,741
6.1 Net Foreign Exchange Assets of RBI	1,28,377	57,525	-5,260	31,462	44,651	-14,595	24,823	23,741
7. Governments' Net Currency Liabilities to the Public	152	37	9	89	17	384	910	-124
8. Net Non-Monetary Liabilities of Banking Sector	1,53,949	30,454	9,969	82,788	30,738	-52,071	4,020	44,848
Memo items								
1. Non-resident Foreign Currency Deposits	802	953	-189	-654	692	550	-447	1,602
2. SCBs' Call-term Borrowing from Financial Institutions	44,853	5,409	530	35,464	3,451	1,395	6,426	2,587
3. Overseas Borrowing by Scheduled Commercial Banks	8,529	3,012	-658	6,267	-90	1,948	6,008	384

Note : Data reflect conversion of a non-banking entity into a banking entity on October 11, 2004.

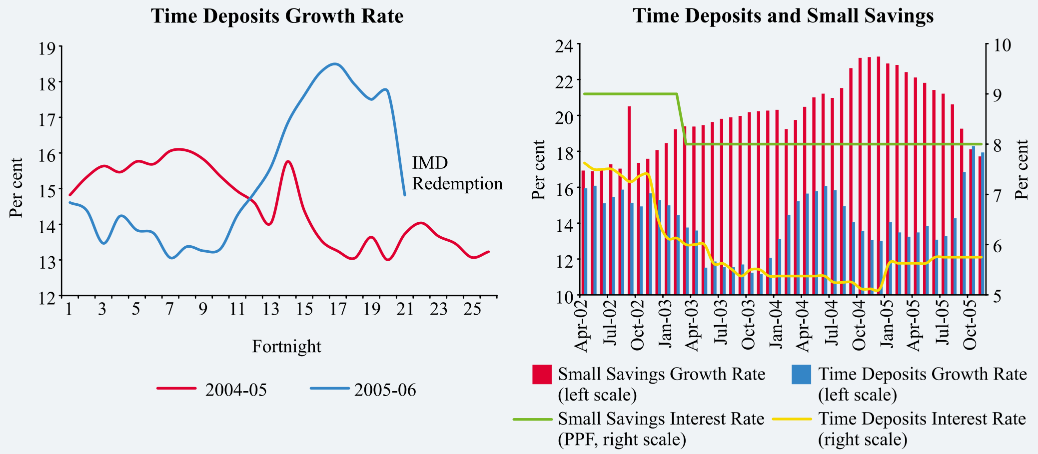
in December 2004. Thus, the differential between the growth rate of small savings and time deposits has narrowed over recent months (Chart 16).

Chart 15: Broad Money Growth - Weighted Contribution of Components



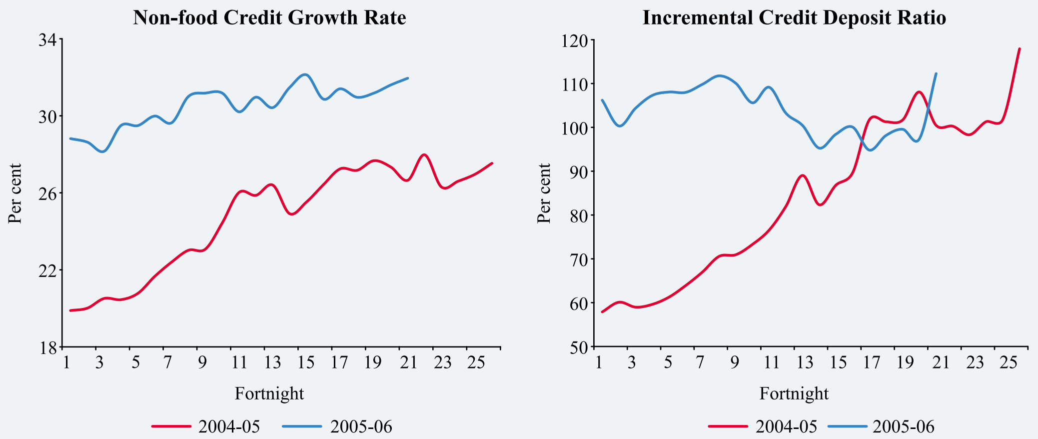
* As on January 6, 2006.

Chart 16: Scheduled Commercial Banks' Time Deposits Growth



Food credit, during the fiscal year so far, has increased by Rs.1,979 crore – reflecting a lower order of procurement of foodgrains – as compared with an increase of Rs.9,098 crore during the corresponding period of the previous year. On the other hand, a broad-based strengthening of economic activity continued to lead the demand for commercial sector's credit demand. Scheduled commercial banks' (SCBs') non-food credit, on a year-on-year basis, registered a growth of 32.0 per cent as on January 6, 2006 on top of a base as high as 26.6 per cent a year ago. Incremental credit-deposit ratio of SCBs continues to hover around 100 per cent (Chart 17). Latest available data indicate that credit pick-up during April-October 2005 was led by agriculture, industry and housing. Non-SLR investments of SCBs, on the other hand, have declined during the current fiscal year. Accordingly, SCBs'

Chart 17: Scheduled Commercial Banks' Credit Growth*



* Year-on-year basis, excluding conversion of a non-banking entity into a banking entity as on October 11, 2004.

non-food credit, adjusted for non-SLR investments, recorded a year-on-year growth of 28.3 per cent as on January 6, 2006 as compared with 27.9 per cent a year ago.

In addition to bank credit, strong flow of funds from non-banks to the corporate sector continued during the third quarter. In particular, resources raised from ADR/ GDR issuances during the quarter ended December 2005 were almost five times the previous quarter. Equity issuances continued to be high during October-December 2005, benefiting from buoyancy in capital markets. Mobilisation through issuances of commercial papers, however, recorded a decline during October-December 2005 in view of tight liquidity conditions in domestic markets. Funds raised through external commercial borrowings (ECBs), after some moderation in the first quarter of 2005-06, again turned substantial during the second quarter. Recourse to medium and long-term ECBs nearly doubled over the first quarter. Short-term trade credits expanded sharply in contrast to a decline in the first quarter. Internal sources – backed by strong corporate sector profitability – also continued to be a substantial source of funds for the corporate sector (Table 17).

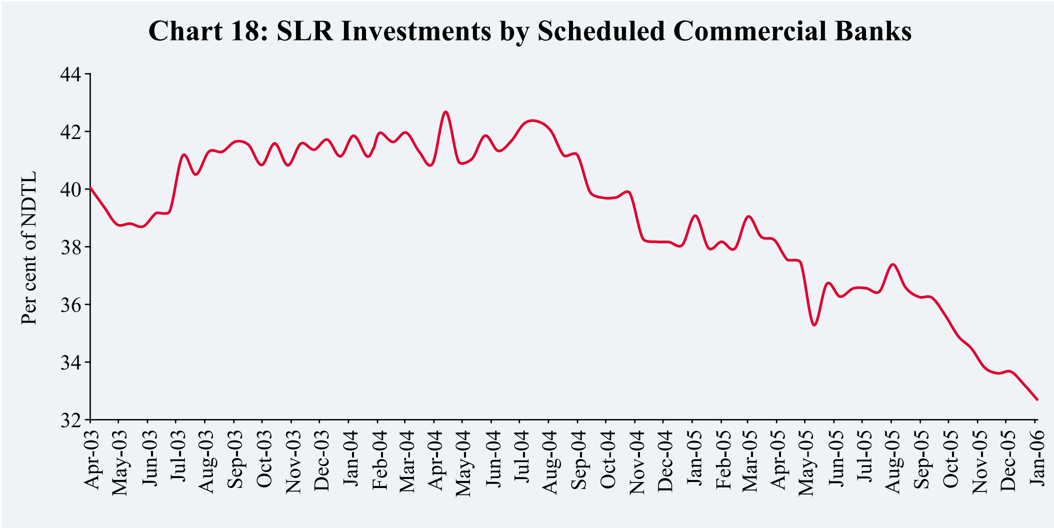
The continued surge in commercial credit had an impact on banks' portfolio of Government papers. The combined gilt portfolio of commercial and co-operative banks has registered a decline of Rs.14,583 crore during the current fiscal so far (up to January 6, 2006) in contrast to an increase of Rs.50,988 crore (net of the conversion effect) a year ago. Consequently, commercial banks' holding of government securities continued its downward trajectory: it fell to around 33 per cent of their net demand and time liabilities (NDTL) as on January 6, 2006 from nearly 36 per cent at end-September 2005 and around 39 per cent a year ago, but still in excess of the statutory requirement of 25.0 per cent (Chart 18).

Table 17: Select Sources of Funds to Industry

(Rupees crore)

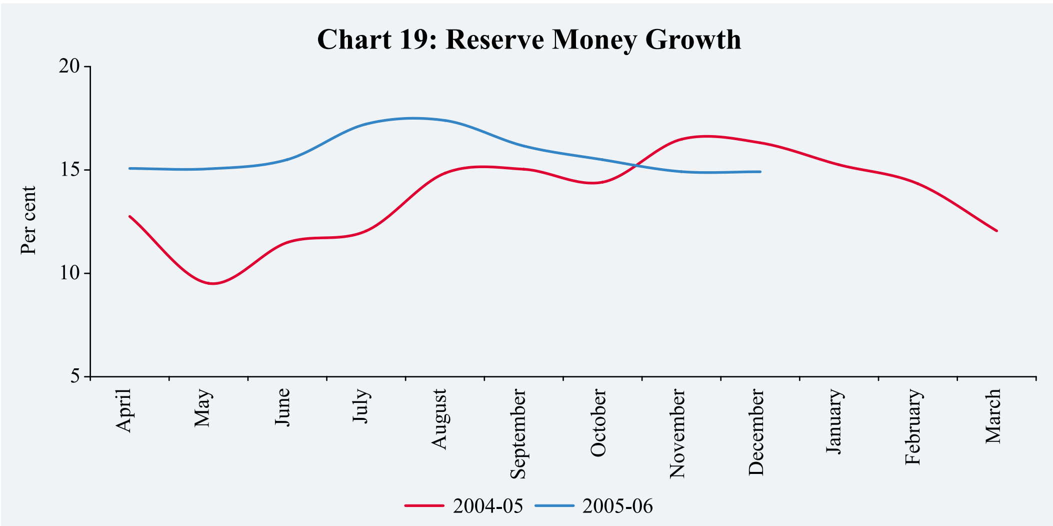
Item	2004-05				2005-06		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
1	2	3	4	5	6	7	8
A. Bank Credit to Industry	6,636	11,186	13,733	21,680	11,148	28,061	9,814@
B. Flow from Non-banks to Corporates							
1. Capital Issues * (i+ii)	228	4,529	3,214	2,495	1,254	4,977	5,397
i) Non-Government Public Ltd. Companies (a+b)	228	4,529	530	2,495	1,254	4,977	5,397
a) Bonds/Debentures	0	0	0	0	118	0	0
b) Shares	228	4,529	530	2,495	1,136	4,977	5,397
ii) PSUs and Government Companies	0	0	2,684	0	0	0	0
2. ADR/GDR Issues +	770	0	872	694	783	739	3,643
3. External Commercial Borrowings (ECBs) $	12,077	3,795	10,481	13,164	3,528	12,736	–
4. Issue of CPs	1,819	421	1,901	963	3,562	1,928	-2,544
C. Depreciation Provision ++	5,504	5,836	5,731	6,106	7,137	7,617	–
D. Profit after Tax ++	10,396	13,004	13,196	16,798	16,726	18,169	–

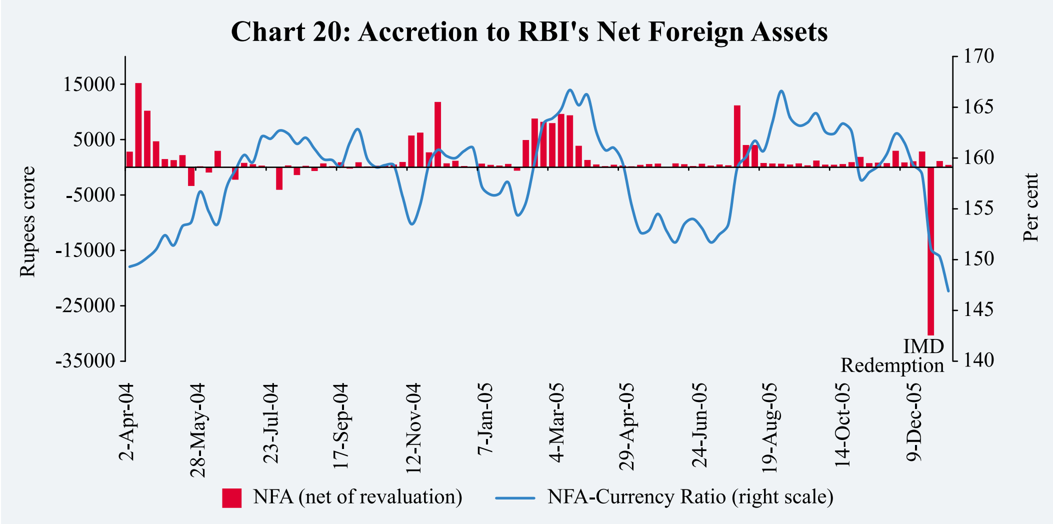
* : Gross issuances excluding issues by banks and financial institutions. Figures are not adjusted for banks' investments in capital issues, which are not expected to be significant.
\+ : Excluding issuances by banks and financial institutions.
$: Including short-term credit. @ : Data pertain to October 2005.
++ : Data are based on audited/ unaudited abridged results of select sample of non-financial non-Government companies.
Note: Data are provisional.



Reserve Money Survey

Reserve money growth as on January 13, 2006 at 19.8 per cent was higher than a year ago (17.3 per cent) (Chart 19). During 2005-06 so far, reserve money growth has generally remained above the growth trajectory of 2004-05 reflecting liquidity injection through LAF operations as well as the effect of the increase in the cash reserve ratio (CRR) by 50 basis points during September-October 2004. The dynamics of reserve money during the third quarter were driven by net injection of liquidity – initially through reversal of reverse repos and subsequently through repos under the LAF operations – in an environment of higher credit demand and redemption of IMDs.





The Reserve Bank's foreign currency assets (net of revaluation) have increased by Rs. 10,719 crore during fiscal 2005-06 (up to January 13) as compared with an increase of Rs. 60,875 crore during the corresponding period of 2004-05. The lower order of increase during the current year reflects redemption of IMDs on December 29, 2005 out of the foreign exchange reserves of the Reserve Bank (Chart 20). Most of the increase in the NFEA during the current fiscal was concentrated in the three-week period during July 23 – August 12, 2005. This period, as a result, witnessed relatively stronger liquidity absorption operations (Table 18).

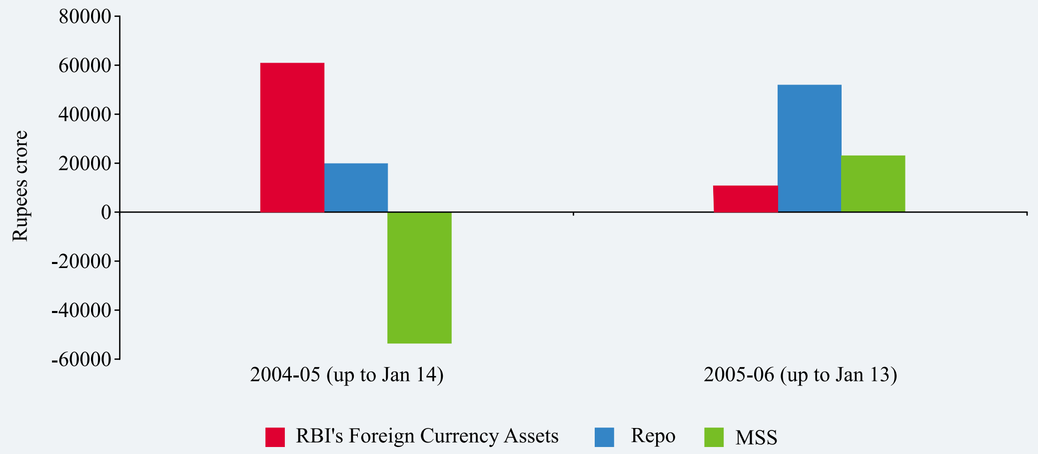
Table 18: Variation in Major Components and Sources of Reserve Money

(Rupees crore)

Item	2004-05	2004-05				2005-06		
		Q1	Q2	Q3	Q4	Q1	Q2	Q3
1	2	3	4	5	6	7	8	9
Reserve Money	52,623	-6,812	-6,285	31,546	34,174	7,177	1,072	25,428
Components								
1. Currency in Circulation	41,633	14,317	-4,166	16,467	15,015	19,877	-9,479	29,130
2. Bankers' Deposits with RBI	9,631	-19,665	-2,874	14,769	17,401	-10,680	9,780	-2,967
3. Other Deposits with RBI	1,359	-1,463	755	310	1,757	-2,021	771	-736
Sources								
1. RBI's net credit to Government	-62,882	-34,143	-6,179	184	-22,744	9,275	-25,251	19,879
of which: to Central Government	-60,177	-30,029	-4,499	203	-25,852	14,600	-25,251	19,812
2. RBI's credit to banks and commercial sector	-833	-2,985	-740	3,726	-835	1,155	-1,869	101
3. NFEA of RBI	128,377	57,525	-5,260	31,462	44,651	-14,595	24,823	23,741
4. Government's Currency Liabilities to the Public	152	37	9	89	17	384	910	-124
5. Net Non-Monetary Liabilities of RBI	12,191	27,245	-5,885	3,916	-13,085	-10,957	-2,460	18,169
Memo items								
1. Net Domestic Assets	-75,754	-64,336	-1,025	84	-10,477	21,771	-23,751	1,687
2. FCA, adjusted for revaluation	115,044	33,160	-3,413	29,858	55,440	5,034	23,665	11,998
3. Net Purchases from Authorised Dealers	91,105	30,032	-9,789	22,771	48,091	0	17,027	0
4. NFEA/Reserve Money (per cent) (end-period)	125.3	126.1	126.7	124.9	125.3	120.5	125.3	123.7
5. NFEA/Currency (per cent)	166.2	158.8	159.2	160.7	166.2	154.0	164.4	158.4

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.

Chart 21: Liquidity Management



In the face of strong credit demand and the lower order of accretion of the foreign exchange reserves to the Reserve Bank during the current fiscal, liquidity management operations during 2005-06 so far have for the most part been in the form of net liquidity injection through operations under the liquidity adjustment facility (LAF) and unwinding of balances under the market stabilisation scheme (MSS) in contrast to liquidity absorption through a heavy reliance on issuances under the MSS during the comparable period of the preceding year (Chart 21).

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 Reserve Bank (Table 19). Mirroring the liquidity

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

(Rupees crore)

Item	2004-05	2004-05				2005-06		
		Q1	Q2	Q3	Q4	Q1	Q2	Q3
1	2	3	4	5	6	7	8	9
Net Reserve Bank Credit to the Centre (1+2+3+4-5)	**-60,177**	**-30,029**	**-4,499**	**203**	**-25,852**	**14,600**	**-25,251**	**19,812**
1. Loans and Advances	0	3,222	-3,222	0	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	-2,900	22,176	14,095	-21,048	8,221	-17,243	19,378
4. Reserve Bank's Holdings of Rupee Coins	57	175	-10	-94	-14	-40	-33	157
5. Central Government Deposits	72,558	30,525	23,443	13,799	4,791	-6,419	7,974	-277
*Memo items**								
1. Market Borrowings of Dated Securities by the Centre#	80,350	28,000	26,000	14,000	12,350	42,000	39,000	24,000
2. Reserve Bank's Primary Subscription to Dated Securities	1,197	0	847	0	350	0	0	0
3. Repos (+) / Reverse Repos (-) (LAF), net position	15,315	-26,720	34,205	27,600	-19,770	9,660	-14,835	18,635
4. Net Open Market Sales +	2,899	429	427	871	1,171	1,543	941	261
5. Mobilisation under MSS	64,211	37,812	14,444	353	11,602	7,469	-4,353	-19,713
6. Primary Operations $	-6,625	37,353	-30,484	-36,984	23,490	18,205	-24,689	-38,715

* : At face value. + : Excluding Treasury Bills but including Consolidated Sinking Funds (CSF) and Other Investments.
# : Excluding Treasury Bills. $: 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.

injection operations, the Reserve Bank's net credit to the Centre has lodged an increase of Rs.69,955 crore during the current fiscal year so far (up to January 13, 2006) in contrast to a decline of Rs.27,012 crore during the comparable period of 2004-05.

Liquidity Management

Against the backdrop of sustained pick-up in domestic credit demand as also the redemption of IMDs, third quarter of fiscal 2005-06 witnessed liquidity injection operations by the Reserve Bank. Liquidity management operations during 2005-06 so far can be analysed in terms of four phases (Table 20). During the first period beginning end-March 2005 up to July 22, 2005, banks scaled down their balances under reverse repos due to the sharp widening of the trade deficit, the FII outflows during April-May 2005 and buoyant credit demand. Reversal of reverse repo operations led to net injection of primary liquidity by the Reserve Bank.

During July 23 - August 12, following the sudden spurt in foreign exchange inflows and a reduction in the Centre's surplus investment balances with the Reserve Bank, liquidity in the system increased considerably; this resulted in a sharp increase in absorption of liquidity by the Reserve Bank through LAF reverse repo rising from Rs.10,485 crore as on July 22 to Rs.37,050 crore as on August 12, peaking at Rs.50,610 crore as on August 3, 2005.

In the third phase (August 13 – October 28), again, the Reserve Bank's purchase of foreign exchange assets moderated. Government surplus balances

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

(Rupees crore)

	April 1 - July 22, 2005	July 23 - August 12, 2005	August 13 - October 28, 2005	October 29, 2005 - January 13, 2006
1	2	3	4	5
A. Drivers of Liquidity (1+2+3)	**-6,737**	**27,792**	**-15,127**	**-62,943**
1. RBI's Foreign Currency Assets (adjusted for revaluation)	6,412	19,348	5,193	-20,235
2. Currency with the Public	-15,274	-1,529	-7,940	-23,685
3. Others (residual)	2,125	9,973	-12,380	-19,023
3.1 Surplus Cash balances of the Centre with the Reserve Bank	6,053	5,972	-7,421	-14,633
B. Management of Liquidity (4+5+6+7)	**1,329**	**-24,567**	**16,187**	**81,985**
4. Liquidity impact of LAF Repos	8,845	-26,565	16,210	53,415
5. Liquidity impact of OMO* (net)	0	0	0	0
6. Liquidity impact of MSS	-7,516	1,998	-23	28,570
7. First round liquidity impact due to CRR change	0	0	0	0
C. Bank Reserves # (A+B)	**-5,408**	**3,225**	**1,060**	**19,042**

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

with the Reserve Bank also started building up leading to some tightness in liquidity. Concomitantly, this phase again experienced unwinding of LAF reverse repo balances (Table 21 and Chart 22). On an average, liquidity conditions were broadly stable and comfortable and the call money rates, therefore, generally stayed within the repo rate corridor. In view of comfortable liquidity conditions till the third phase, the Reserve Bank injected liquidity through LAF repos only on four occasions; on a net basis, the Reserve Bank absorbed liquidity even on those four days.

During the fourth phase (end-October 2005 to mid-January 2006), the banking system faced tightness with liquidity pressures emanating from festival season currency demand, scheduled auctions, advance tax outflows and redemption of IMDs against the backdrop of sustained growth in credit demand. In view of the tight liquidity conditions, the Reserve Bank provided liquidity on a net basis to the market through repo operations during November 9-18, 2005 (daily average net injection of Rs.1,094 crore). In order to assuage the liquidity conditions, auctions of Treasury Bills (TBs) under the MSS were cancelled effective

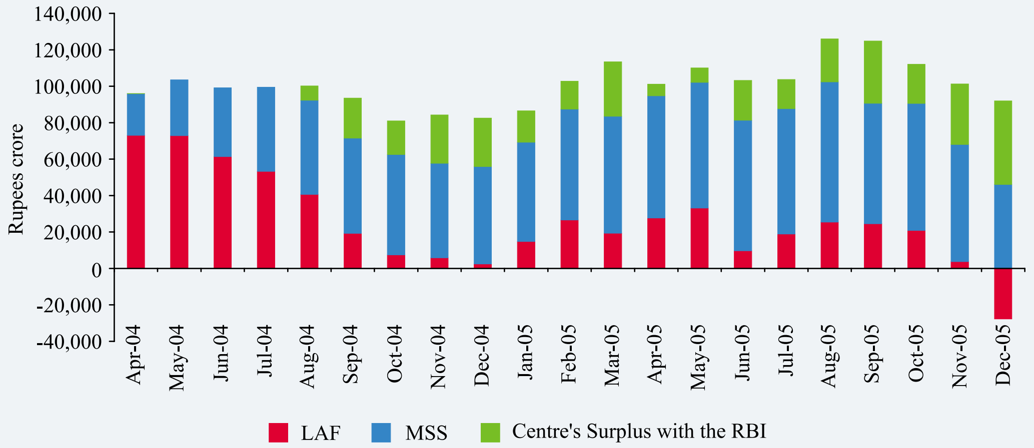
Table 21: Liquidity Overhang

(Rupees crore)

Outstanding as on last Friday of	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	20,840	69,752	21,498	1,12,090
November	3,685	64,332	33,302	1,01,319
December	-27,755#	46,112	45,855	64,212
2006				
January*	-32,575#	41,183	36,348	44,956

* :As on January 14, 2006.
\# :Negative sign indicates injection of liquidity through LAF repo.
@: Excludes minimum cash balances with the Reserve Bank.

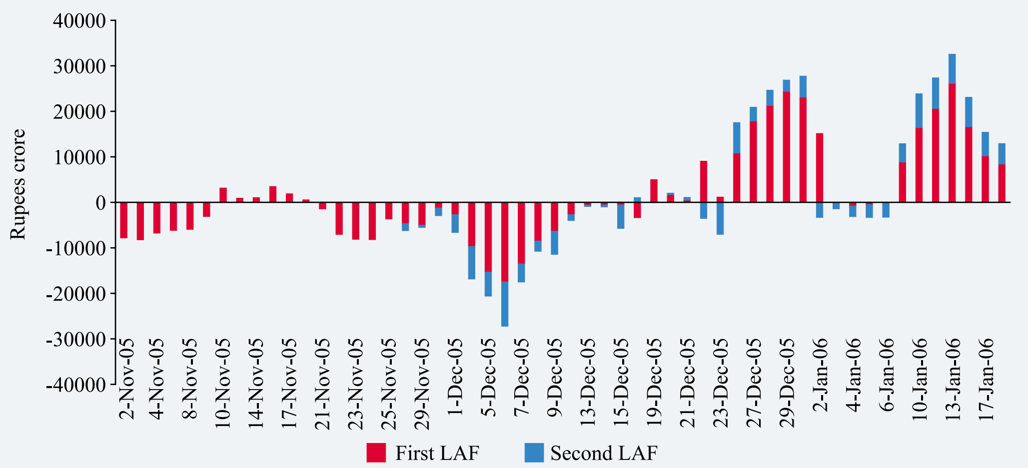
Chart 22: Liquidity Overhang

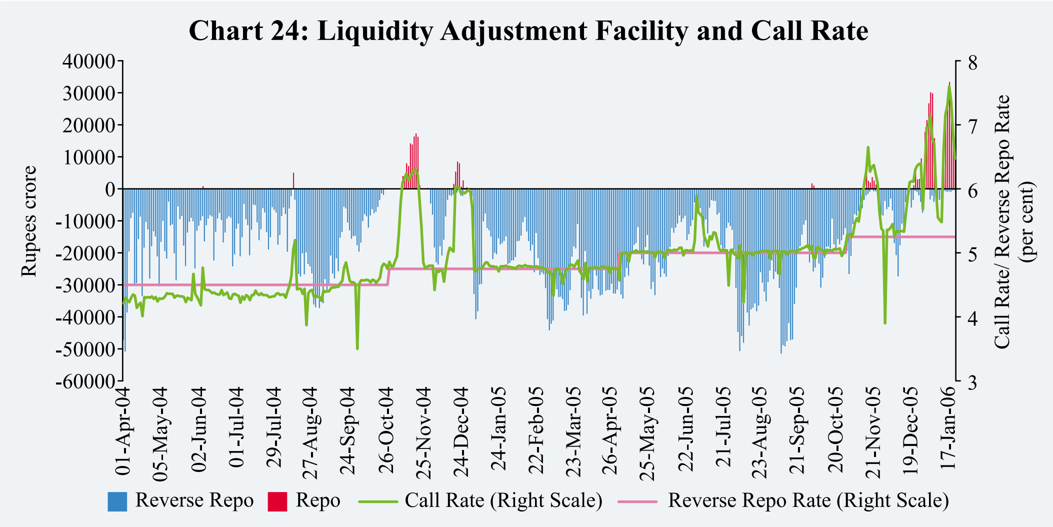


November 16, 2005. Moreover, to fine-tune the management of liquidity and in response to suggestions from the market participants, the Reserve Bank introduced a Second Liquidity Adjustment Facility (SLAF), with effect from November 28, 2005 (Chart 23).

Liquidity pressures again emerged from the second week of December 2005 and the outstanding balances under LAF reverse repos started coming down. The pressures increased further as advance tax outflows coincided with the redemption of the IMDs. In connection with the redemption of IMDs, the Reserve Bank sold foreign exchange of US $ 7.1 billion out of its foreign exchange reserves to the State Bank of India during December 27-29, 2005 against equivalent rupees

Chart 23: Repo (+)/ Reverse Repo (-) under LAF





(Rs.31,959 crore). Reflecting the liquidity conditions, call rates remained above the repo rate during the second half of December 2005. Although during this phase there was unwinding of MSS balances on account of the decision to cancel the MSS portion of the TB auctions, liquidity pressures persisted. The Reserve Bank, therefore, injected liquidity through repo operations with a peak amount of Rs.30,110 crore on December 29, 2005 (daily average net injection of Rs.23,138 crore during December 26, 2005 - January 2, 2006) (Chart 24). Commercial banks' borrowing from the Reserve Bank also increased during the fourth phase (Rs.2,089 crore) reflecting the liquidity conditions. On a review of the prevalent macroeconomic, monetary and liquidity conditions, including the redemptions of IMDs, the Reserve Bank decided on December 30, 2005 to suspend the issue of Treasury Bills and dated securities under the MSS. However, within the overall MSS ceiling for 2005-06, the Reserve Bank would retain the flexibility of conducting auctions under the MSS from time to time with sufficient notice to the market, in response to evolving circumstances. All these measures along with the smooth redemption of the IMDs and reduction in the Centre's surplus investments eased the liquidity conditions during the first week of January 2006 and the call rates softened. Liquidity pressures re-emerged from the second week of January 2006 on account of outflows under auctions of dated securities. The Reserve Bank, therefore, injected liquidity through LAF repos during January 9-18, 2006. The outstanding repo amount stood at Rs.12,935 crore as on January 18, 2006.

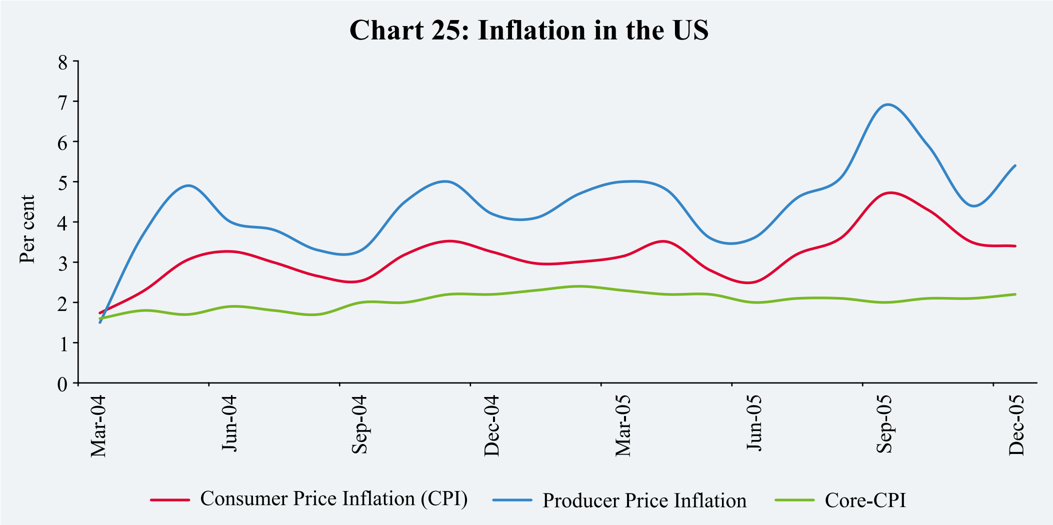
IV. PRICE SITUATION

Headline inflation, which had edged up sharply in a number of economies during September 2005 on account of international crude oil prices reaching record highs in August 2005, eased marginally during the fourth quarter of 2005 in tandem with some moderation in crude oil prices. Notwithstanding the recent easing, headline inflation remains at elevated levels - above the targets in case of many central banks. The impact of higher oil prices on economic activity and inflation expectations seems to have been largely contained reflecting a variety of factors such as increased competition due to globalisation, fall in intensity of oil usage in advanced economies, continuous pre-emptive monetary tightening through measured increases in policy rates and, in case of many emerging market economies, less-than-complete pass-through. Nonetheless, as a significant part of the increase in international crude oil prices is increasingly viewed as somewhat permanent, the outlook for inflation remains uncertain in view of possible second-round effects.

In India, headline inflation and inflation expectations remained well-contained during the quarter ended December 2005, 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 have been successful in containing inflation towards the desired trajectory during the financial year so far.

Global Inflation

In the US, consumer price inflation, which had accelerated from 2.5 per cent in June 2005 to 4.7 per cent by September 2005 due to sharp increase in energy costs, eased to 3.4 per cent by December 2005. Core inflation (*i.e.,* excluding food and energy prices), on the other hand, at around 2.0 per cent has been broadly unchanged since early 2005 although there are concerns that elevated energy prices could put pressure on core inflation (Chart 25). Reflecting the strong economic activity and the incipient inflationary pressures, the US Federal Reserve persevered with its measured pace of monetary tightening raising its target Federal Funds rate by a further 150 basis points over end-March 2005 (25 basis points hike at each of its six meetings) to take the Fed Funds rate to more neutral levels. According to the US Federal Open Market Committee (FOMC), although possible increases in resource utilisation and elevated energy prices have the potential to add to inflation pressures, longer-term inflation expectations in the US remain contained. The FOMC believes that some further measured policy firming is needed to keep the risks to the attainment of both sustainable growth and price stability roughly in balance.



In the euro area too, inflation, measured by the Harmonised Index of Consumer Prices (HICP), eased - from the recent peak of 2.5 per cent in September 2005 - to 2.2 per cent in December 2005 but still exceeding the target of 'below but close to 2.0 per cent'. Nonetheless, upside risks are seen by the European Central Bank (ECB) due to the potential second-round effects in wage and price setting behaviour from oil market developments and further increases in administered prices and indirect taxes. The ECB, therefore, raised the key policy rate by 25 basis points on December 1, 2005 - after maintaining rates at historically low levels for two and a half years - to keep medium to long-term inflation expectations in the euro-area anchored to levels consistent with price stability (Table 22). The ECB kept the key policy rates unchanged at its meeting held on January 12, 2006.

Table 22: Inflation Indicators – Developed Economies

(Per cent)

Country/ Region	Key Policy Rate/Bank Reserve Target	Policy Rates (January 18, 2006)	Changes in Policy Rates in basis points (since end-December 2004)	2004		2005 (Latest)	
				Inflation	Growth (y-o-y)	Inflation (December)	Growth (y-o-y) (Q3)
1	2	3	4	5	6	7	8
Australia	Cash Rate	5.50	25	2.3	3.2	3.0 *	2.6
Canada	Overnight Rate	3.25	75	1.8	2.9	2.2	2.8
Euro area	Interest Rate on Main Refinancing Operations	2.25	25	2.1	2.0	2.2	1.6
Japan	Target Balance of Current Account	30-35 trillion yen	Unchanged	0.0	2.7	-0.8 #	2.9
New Zealand	Official Cash Rate	7.25	75	2.3	4.8	3.4 *	2.3
UK	Repo Rate	4.50	(-) 25	1.3	3.2	2.0	1.7
US	Federal Funds Rate	4.25	200	2.7	4.2	3.4	3.6

* : Q3. # : November. y-o-y : year-on-year.

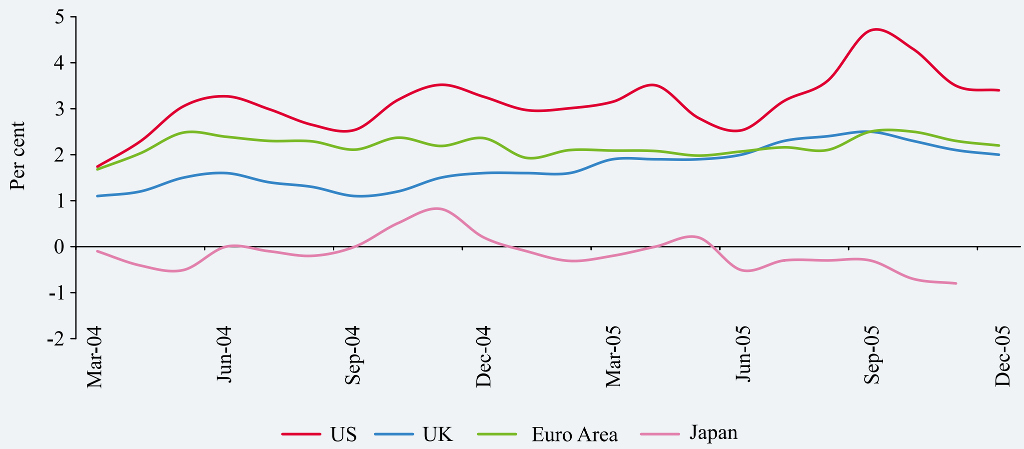
Source: International Monetary Fund; websites of respective central banks; and The Economist.

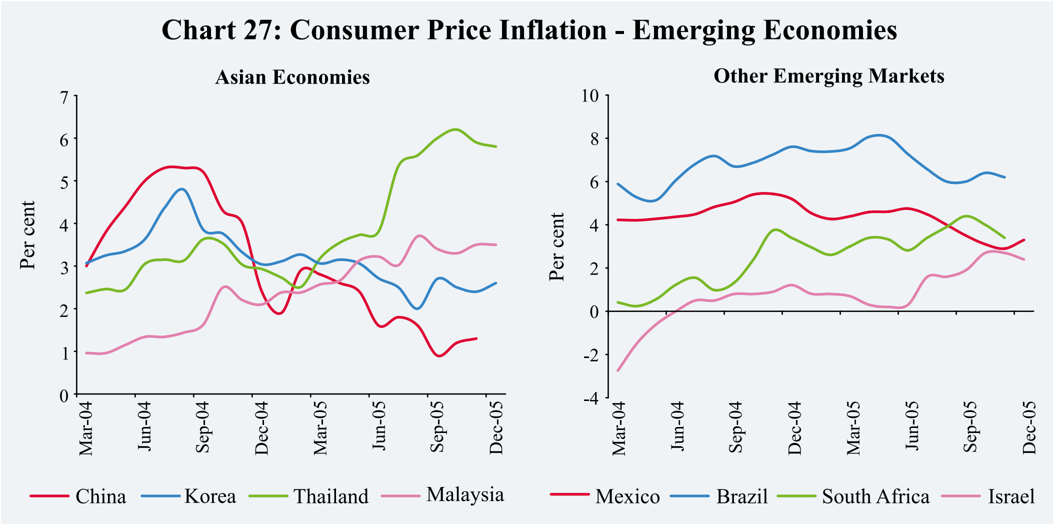
In the UK, CPI inflation which had accelerated to 2.5 per cent in September 2005 – the highest rate since January 1997 – driven up by higher oil prices eased to 2.0 per cent in December 2005. The Bank of England, which had cut the policy repo rate by 25 basis points on August 4, 2005 in response to the weakening of economic activity, persevered with the policy stance although inflation is expected to remain above the target of 2.0 per cent in the near term.

In Japan, mild deflation continues despite economic recovery. Consumer prices, year-on-year, declined by 0.8 per cent in November 2005 as against an increase of 0.8 per cent a year ago (Chart 26). Core CPI, however, turned positive (0.1 per cent) for the first time after a gap of two years. With annual rate of change in consumer prices projected to turn slightly positive on the back of improving supply-demand conditions, 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, consumer price inflation decelerated to 1.3 per cent in November 2005 from 4.0 per cent a year ago, due mainly to a decline in the prices of grains, clothing, communication services and some consumer durables (Chart 27). Amongst other Asian economies, inflation in Indonesia edged up sharply from 9.1 per cent in September 2005 to 17.1 per cent in December 2005, driven up by further increases in administered fuel prices and currency depreciation. With core inflation projected to be 9.5 per cent – above the medium-term inflation target of 6 (+/-1) per cent - the Bank Indonesia continued to tighten monetary policy. It has raised the policy rate by 275 basis points since end-September 2005 - 100 basis points hike on October 4, 2005, 125 basis points hike on November 1, 2005 and another 50 basis points hike on December 6, 2005 - to 12.75 cent. In the Philippines too, CPI inflation at 6.6 per cent in December 2005

Chart 26: Consumer Price Inflation - Developed Economies





remained above the target of 5-6 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 has raised the policy reverse repo rate further by 25 basis points in October 2005 to 7.5 per cent. However, with some easing of energy prices, a normal weather, the strengthening of peso and generally favourable demand-side pressures, the Bank of Philippines has since then left the key policy rates unchanged.

In Thailand, headline (6.2 per cent) inflation accelerated in October 2005 driven up by persistent increases in oil prices before easing somewhat to 5.8 per cent in December 2005. With growth momentum remaining strong and probability of core inflation exceeding the target range (0-3.5 per cent), the Bank of Thailand has raised policy interest rates further by 100 basis points since end-September 2005 - 50 basis points on October 19, 2005 and 25 basis points each on December 14, 2005 and January 18, 2006 - to 4.25 per cent (Table 23). In Korea, inflation moderated somewhat from 2.7 per cent in September 2005 to 2.6 per cent in December 2005 (3.0 per cent a year ago). Nonetheless, latent inflationary pressures are seen due to strong economic recovery and the persistently high oil prices. The Bank of Korea has accordingly raised the policy rate by 50 basis points since end-September 2005 - 25 basis points each on October 11, 2005 and December 8, 2005 - to 3.75 per cent.

To conclude, inflation pressures which had increased in the third quarter of calendar year 2005, moderated somewhat in a number of economies in the fourth quarter with some easing in energy prices. Notwithstanding this moderation, inflation remains at elevated levels in most of the economies. Although the second round effects of recent oil prices hikes have been muted so far and core inflation remains low, the prospect of a higher second round pass-through has prompted

Table 23: Inflation Indicators – Developing Economies

(Per cent)

Country/ Region	Key Policy Rate/Bank Reserve Target	Policy Rates (January 18, 2006)	Changes in Policy Rates in basis points (since end-December 2004)	2004		2005 (Latest)	
				Inflation	Growth (y-o-y)	Inflation (December)	Growth (y-o-y) (Q3)
1	2	3	4	5	6	7	8
Brazil	Selic Rate	17.25	(-) 50 @	6.6	4.9	6.2 ^	1.0
China	M2	—	—	3.9	9.5	1.3 ^	9.4
India	Reverse Repo Rate	5.25	50	3.8	6.9 *	5.3 ^	8.1
Israel	Key Rate	4.50	60	(-) 0.4	4.4	2.4	5.7
Korea	Overnight Call Rate	3.75	50	3.6	4.6	2.6	4.5
Philippines	Reverse Repo Rate	7.50	75	6.0	6.0	6.6	4.1
South Africa	Repo Rate	7.00	(-) 50	1.4	3.7	3.4 ^	4.9
Thailand	14-day Repo Rate	4.25	225	2.7	6.1	5.8	5.3

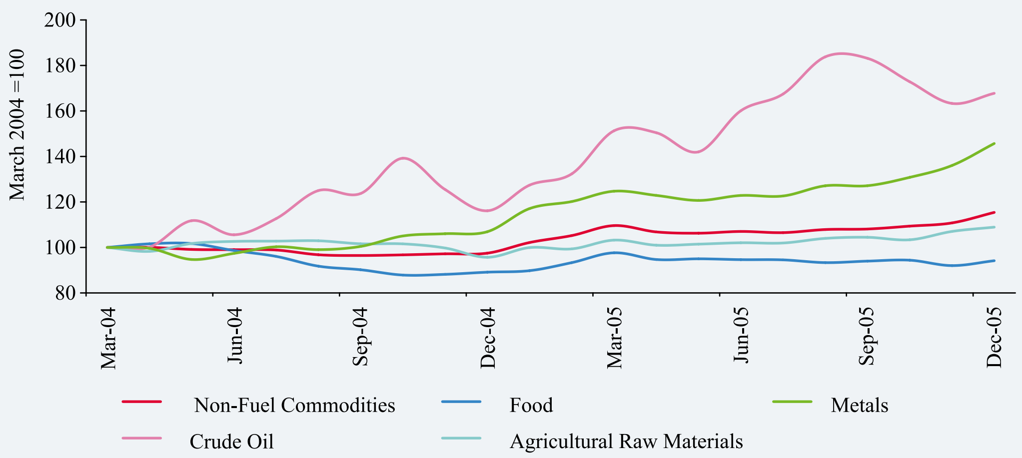
* : Fiscal year 2004-05. @ : Reduced policy rate by 225 basis points since end-September 2005.
^ : November. y-o-y : year-on-year.
Source: International Monetary Fund; websites of respective central banks; and The Economist .

a number of central banks to tighten monetary policy during the recent months in order to contain inflation and inflationary expectations.

Global Commodity Prices

After recording continuous upward movements to record highs in August 2005, international crude oil prices moderated somewhat during November-December 2005 but again increased during January 2006 (Chart 28). Non-fuel commodity prices edged higher during the quarter ended December 2005 due to increases in metals prices.

Chart 28: International Commodity Prices



Strong growth in global demand, economic resilience to higher energy costs, supply concerns due to hurricane-related disruptions in the US (hurricanes Katrina and Rita during August-September 2005) and a three decade low global oil spare capacity supported oil prices during 2005 despite periodic increases in supply by the Organisation of the Petroleum Exporting Countries (OPEC). Besides fundamentals, concerns over stability of supplies from the Middle East due to geo-political uncertainties as well as speculative purchases by hedge funds further added to nervousness in the world oil market imparting a great deal of volatility to oil prices. Reflecting these factors, international crude oil prices reached successive record highs during 2005 - the US West Texas Intermediate (WTI) crude prices rose to an all-time peak of US $ 70.8 a barrel on August 30, 2005 in the immediate aftermath of Hurricane Katrina. Prices then moderated to below US $ 60 a barrel during November-December 2005 due to a variety of factors: 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; OPEC's decision to make available existing spare capacity in member countries of around 2 mb/d for a three-month period in its Vienna meeting during September 19-20, 2005; firmer signs of slowing global demand growth; significant recovery from hurricane damages to oil production in the Gulf of Mexico; and relatively warmer weather during October-November 2005. Notwithstanding this moderation, international crude oil prices have surged by about 67 per cent from US $ 33.7 per barrel in March 2004 to US $ 56.4 per barrel in December 2005 (Table 24). Prices, however, again edged higher to reach US $ 67 a barrel on January 18, 2006 on reports of a decline in US crude stocks, disruption of Russian natural gas deliveries to Ukraine threatening supplies to Western Europe, tensions over Iran's nuclear programme and unrest in Nigeria.

With limited spare global crude oil production capacity and the U.S. oil production and refining industries still to recover fully, oil prices are likely to react sharply to any additional disruption of or damage to petroleum infrastructure (Table 25). Accordingly, oil prices are expected to remain firm in the near future.

Table 24: International Crude Oil Prices

(US dollars per barrel)

Item	2002-03	2003-04	2004-05	March 2005	June 2005	September 2005	November 2005	December 2005
1	2	3	4	5	6	7	8	9
Dubai Crude	25.9	26.9	36.4	45.6	51.0	56.5	51.3	53.1
UK Brent	27.6	29.0	42.2	53.1	54.3	63.0	55.5	56.7
US WTI	29.2	31.4	45.0	54.2	56.4	65.5	58.3	59.4
Average Crude Price	**27.6**	**29.1**	**41.3**	**50.9**	**53.9**	**61.7**	**55.0**	**56.4**
Memo:								
Indian Basket Price	**26.6**	**27.8**	**38.9**	**48.8**	**52.4**	**59.3**	**53.1**	**54.7**

Source: International Monetary Fund and the World Bank.

Table 25: World Supply-Demand Balance of Oil

(Million barrels per day)

Item	2002	2003	2004	2005	2006 P	2006 P			
						Q1	Q2	Q3	Q4
1	2	3	4	5	6	7	8	9	10
Demand									
1. OECD	47.9	48.7	49.5	49.6	50.2	50.7	49.0	50.2	51.0
2. Non-OECD	30.4	31.2	33.0	34.1	35.1	34.6	34.7	34.9	36.3
China	5.2	5.6	6.5	6.9	7.4	7.2	7.4	7.4	7.7
3. Total (1+2)	78.4	79.9	82.5	83.7	85.3	85.3	83.6	85.1	87.3
Supply									
4. Non-OPEC	47.9	48.9	50.1	50.1	51.1	50.7	50.7	51.2	51.8
5. OPEC	29.0	30.7	32.9	33.9	34.3	34.0	34.0	34.6	34.7
6. Total (4+5)	76.9	79.6	83.1	84.1	85.4	84.7	84.7	85.8	86.5
Stock Changes	1.5	0.3	-0.6	-0.4	-0.1	0.6	-1.1	-0.7	0.9

P: Projections.
Source: Short-term Energy Outlook, US Energy Information Administration, January 2006.

The Energy Information Administration (EIA) of the US, for instance, expects WTI prices to average US $ 63 per barrel in 2006 (US $ 57 a barrel in 2005).

Turning to non-fuel commodities, food prices declined by about four per cent between March 2005 and December 2005. Although international wheat prices remain higher than a year ago, prices are expected to moderate in view of good harvest for the 2005 crop and favourable prospects for the newly-sown 2006 crop. Rice prices are expected to moderate in the coming months on the back of a record 2005 paddy output. Expectations about large export supplies from countries like Thailand and Vietnam coupled with reduced import requirements in some of the major importing countries in Asia are likely to put downward pressures on rice prices. Prices of oilseeds, which had edged up during March-June 2005 due to sudden deterioration of production prospects in South America, have been easing since August 2005 with the waning of weather concerns and record carryover stocks at the close of the marketing season (October-September). On the other hand, notwithstanding some easing during the later half of 2005 on the back of record soybean and palm oil production in 2004-05 season, prices of edible oils and fats are expected to strengthen due to strong consumption demand from China and India and demand for non-food uses like biodiesel from the EU and the US (Table 26).

After remaining broadly stable during April-June 2005, sugar prices firmed up during September-December 2005 reflecting declining global inventories. Although global production in 2005-06 season (October-September) is expected to increase led by record harvest in Brazil and a recovery in India, higher global sugar consumption especially from the developing countries of the Far East and Latin America and declining stocks in China and India are likely to keep sugar prices firm in the coming months.

Table 26: World Commodity Prices

(Index 1995=100)

Commodity / Group	2002-03	2003-04	2004-05	March 2005	June 2005	September 2005	December 2005
1	2	3	4	5	6	7	8
All Commodities	**113.5**	**122.6**	**161.2**	**189.3**	**195.5**	**216.7**	**208.9**
A. Fuel	**151.4**	**162.3**	**228.7**	**276.8**	**292.6**	**335.7**	**311.4**
Crude Oil	160.2	169.1	239.8	296.0	313.2	358.4	328.3
Average Crude Price (US $/barrel)	27.6	29.1	41.3	50.9	53.9	61.7	56.5
Coal (US $/tonne)	26.2	32.3	56.8	52.7	52.8	47.0	39.4
B. Non-fuel Commodities	**78.8**	**86.1**	**99.4**	**109.1**	**106.5**	**107.6**	**114.9**
Metals	73.0	88.1	116.2	136.8	134.7	139.4	159.8
Aluminium (US $/tonne)	1354.4	1496.5	1781.4	1987.5	1731.9	1837.7	2250.9
Copper (US $/tonne)	1586.2	2044.8	2998.5	3378.9	3529.7	3850.7	4577.0
Zinc (US $/tonne)	776.5	898.4	1109.6	1374.0	1273.1	1396.7	1819.4
Steel Products #	70.4	85.2	129.6	136.9	142.2	138.6	138.6
Agricultural Raw Materials	80.6	82.1	85.7	87.8	86.8	88.8	92.6
Cotton (Cotton Outlook 'A' Index) (US cents per pound)	50.3	67.3	56.8	56.2	54.0	54.9	56.5
Food Products	83.8	89.6	97.8	101.7	98.6	97.9	98.1
Rice (US $/tonne)	193.5	204.9	263.7	295.0	287.0	287.4	277.3
Wheat (US $/tonne)	154.5	150.5	153.7	151.0	141.9	159.7	164.4
Sugar (Free Market) (US cents per pound)	6.7	6.5	8.3	8.9	9.0	10.8	13.9
Palm Oil (US $/tonne)	384.5	430.9	399.7	374.8	369.6	370.0	368.9
Soybean Oil (US $/tonne)	436.8	560.4	532.5	513.1	529.7	496.9	466.0

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

Global cotton prices - which had declined till August 2005 reflecting a rebound in production - increased somewhat during October-December 2005 on the back of forecasts about lower global production during 2005-06 season. Global production is expected to fall by about five per cent during 2005-06 due to decreased plantings in China, Brazil, Argentina and Australia. On the other hand, world consumption is estimated to increase by four per cent during 2005-06 - China alone accounting for about 86 per cent of the increase. The International Cotton Advisory Committee (ICAC), therefore, expects prices to harden by about 25 per cent in 2005-06.

Metal prices firmed up further in the fourth quarter of calendar 2005 on the back of robust construction and manufacturing demand from China and the US. The rally in metal prices during the quarter was led by sharp increases in the prices of copper, zinc and aluminium. With inventories falling to historical lows, copper prices have increased sharply by about 35 per cent between March 2005 and December 2005 on top of an increase of about 47 per cent during 2004-05. Zinc and aluminium prices also increased by about 32 per cent and 13 per cent, respectively, between March 2005 and December 2005. Steel prices - after easing somewhat during July 2005 on the back of strong increase in Chinese production, higher inventories in the US and sluggish demand in Japan - have stabilised in the recent months on the back of supply management efforts by major steel producers in the form of production cuts. Large build-up of capacity in China might put some downward pressures on global steel prices in the coming months. At the same time, demand for various metals is expected to remain strong in view of ongoing strong global activity and this could keep metal prices firm.

Inflation Conditions in India

Headline inflation, measured by year-on-year (y-o-y) changes in the wholesale price index (WPI), has moved in a range of 4.0-4.9 per cent since end-September 2005. WPI inflation stood at 4.4 per cent on December 31, 2005 – after touching an intra-year low of 3.3 per cent on August 27, 2005 - as compared with 5.1 per cent at end-March 2005 (and 5.7 per cent a year ago). The average WPI inflation rate eased to 4.7 per cent on December 31, 2005 from 6.5 per cent a year ago. 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 series of monetary measures by the Reserve Bank along with the fiscal measures have helped in reining in inflation and inflationary expectations during the financial year so far. Another hike in the reverse repo rate by 25 basis points to 5.25 per cent in October 2005 especially in the context of developments in the oil economy - in addition to 50 basis points increase in cash reserve ratio during September-October 2004 and an increase of 25 basis points each in reverse repo rate in October 2004 and April 2005 - indicated the resolve of the monetary policy to contain inflation in the projected range of 5.0-5.5 per cent.

Inflation outcome during 2005-06 so far has been dominated by the price movements of a few commodities such as vegetables, iron and steel and petroleum products. These commodities with a combined weight of about 12 per cent in the WPI basket contributed more than one half of the headline inflation rate of 4.4 per cent on December 31, 2005 (Table 27).

Mineral oils inflation alone contributed about one-third of the headline inflation. Accordingly, the y-o-y WPI inflation excluding the fuel group - at 3.4 per cent on December 31, 2005 - continued to remain below the headline rate (Chart 29).

Domestic petroleum products prices have lagged the increase in international crude oil prices, with the burden being shared by the oil companies and the Central Government. It needs to be stressed that the pass-through of higher international oil prices has been restricted mainly to petrol and diesel. Domestic prices of liquefied petroleum gas (LPG) and kerosene oil have remained unchanged during the year so far. As compared with an increase of about 71 per cent - from US \$ 31.9 a barrel to US \$ 54.7 a barrel - in international crude oil prices (the

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

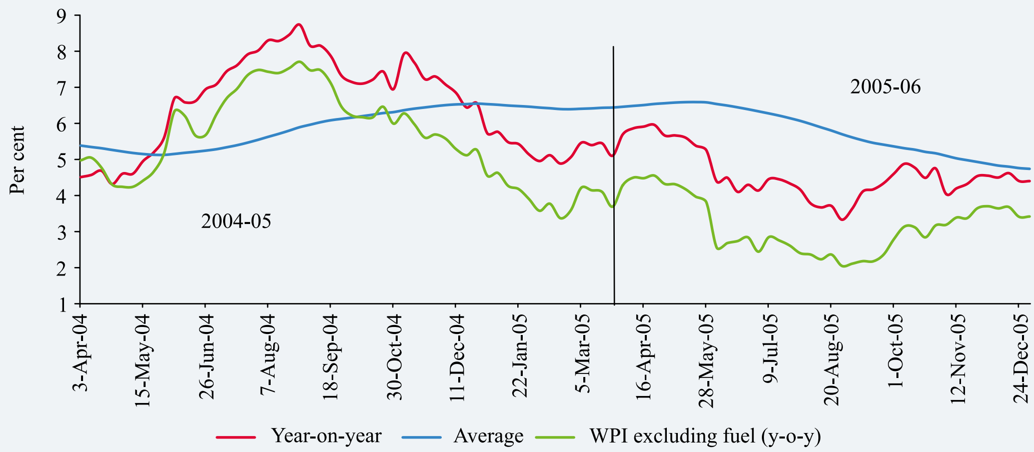
(Per cent)

Commodity		2004-05		2004-05 (January 1, 2005)		2005-06 P (December 31, 2005)	
	Weight	Inflation	WC	Inflation	WC	Inflation	WC
1	2	3	4	5	6	7	8
All Commodities	**100.0**	**5.1**	**100.0**	**5.7**	**100.0**	**4.4**	**100.0**
1. Primary Articles	**22.0**	**1.3**	**5.5**	**2.0**	**7.8**	**4.9**	**24.1**
Food Articles	15.4	3.0	8.9	2.1	5.6	6.9	23.6
i. Rice	2.4	2.9	1.3	2.7	1.1	3.1	1.5
ii. Wheat	1.4	-1.1	-0.3	-1.1	-0.3	5.7	1.8
iii. Pulses	0.6	-2.6	-0.3	0.5	0.0	15.6	2.0
iv. Vegetables	1.5	11.9	2.3	-11.9	-2.5	42.7	9.8
v. Fruits	1.5	11.5	4.1	5.4	1.8	2.2	0.9
vi. Milk	4.4	-1.7	-1.5	3.7	2.8	-0.7	-0.7
vii. Eggs, Meat and Fish	2.2	7.3	3.1	7.9	3.2	12.8	6.8
Non-Food Articles	6.1	-6.9	-8.8	-4.5	-5.1	-3.2	-4.3
i. Raw Cotton	1.4	-23.8	-6.5	-22.5	-5.6	6.4	1.5
ii. Oil Seeds	2.7	-6.5	-3.4	-1.3	-0.6	-13.2	-7.5
iii. Sugarcane	1.3	-0.7	-0.2	-0.7	-0.2	0.7	0.3
Minerals	0.5	68.0	5.3	133.8	7.4	30.8	4.9
i. Iron Ore	0.2	119.1	5.2	290.0	7.5	37.4	4.6
2. Fuel, Power, Light and Lubricants	**14.2**	**10.5**	**42.7**	**10.2**	**37.1**	**7.9**	**39.3**
i. Mineral Oils	7.0	16.0	34.9	14.9	29.3	12.5	34.6
ii. Electricity	5.5	0.8	1.2	1.6	2.2	2.7	4.6
iii. Coal Mining	1.8	17.1	6.4	16.7	5.7	0.3	0.2
3. Manufactured Products	**63.7**	**4.6**	**52.0**	**5.5**	**55.0**	**2.8**	**36.1**
i. Food Products	11.5	0.4	0.9	5.6	10.5	0.8	1.9
of which: Sugar	3.6	19.7	10.3	27.8	12.2	1.8	1.3
Edible Oils	2.8	-8.4	-4.0	-4.7	-2.1	-6.9	-3.5
Oil Cakes	1.4	-17.4	-6.4	-3.7	-1.0	-4.9	-1.6
ii. Cotton Textiles	4.2	-12.7	-10.4	-9.3	-6.7	-2.3	-1.8
iii. Man Made Fibre	4.4	0.6	0.3	2.7	1.1	-3.3	-1.6
iv. Chemicals and Chemical Products	11.9	3.9	9.1	3.1	6.4	2.9	7.8
of which : Fertilisers	3.7	3.3	2.2	1.0	0.6	2.5	1.9
v. Basic Metals, Alloys and Metal Products	8.3	17.1	28.4	17.4	25.3	6.4	13.4
of which: Iron and Steel	3.6	21.3	17.0	21.3	15.0	6.7	7.1
vi. Non-Metallic Mineral Products	2.5	11.4	4.7	5.1	1.9	6.5	3.1
of which: Cement	1.7	10.2	2.9	0.3	0.1	10.0	3.1
vii. Machinery and Machine Tools	8.4	7.1	8.6	7.9	8.6	2.2	3.1
viii. Transport Equipment and Parts	4.3	6.2	4.3	5.7	3.5	2.8	2.2
Memo:							
Food Items (Composite)	**26.9**	**1.9**	**9.8**	**3.5**	**16.1**	**4.4**	**25.5**
WPI Excluding Food	**73.1**	**6.3**	**90.2**	**6.5**	**83.9**	**4.4**	**74.5**
WPI Excluding Fuel	**85.8**	**3.7**	**57.3**	**4.5**	**62.9**	**3.4**	**60.7**

P: Provisional. WC: Weighted Contribution.

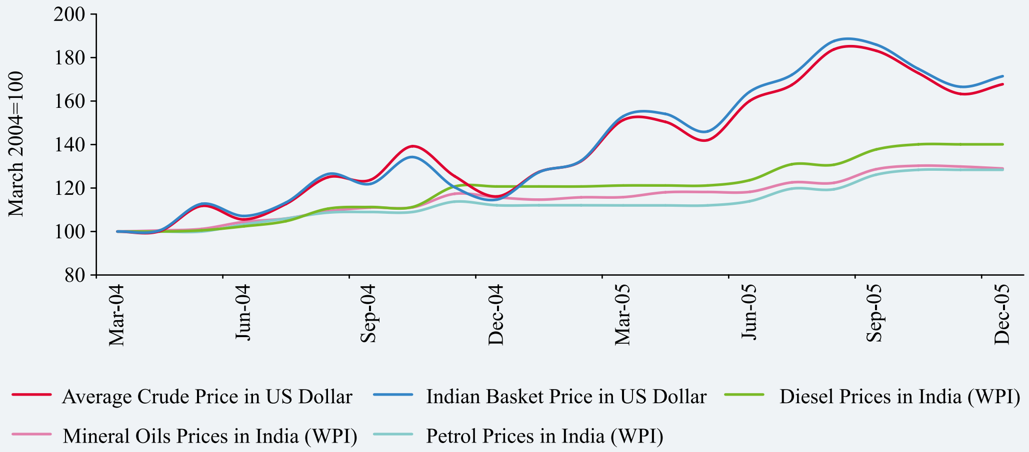
Indian basket) between March 2004 and December 2005, domestic mineral oil prices in the WPI basket have increased by about 29 per cent over the same period – petrol by 28.4 per cent and high-speed diesel by 40.1 per cent (Chart 30).

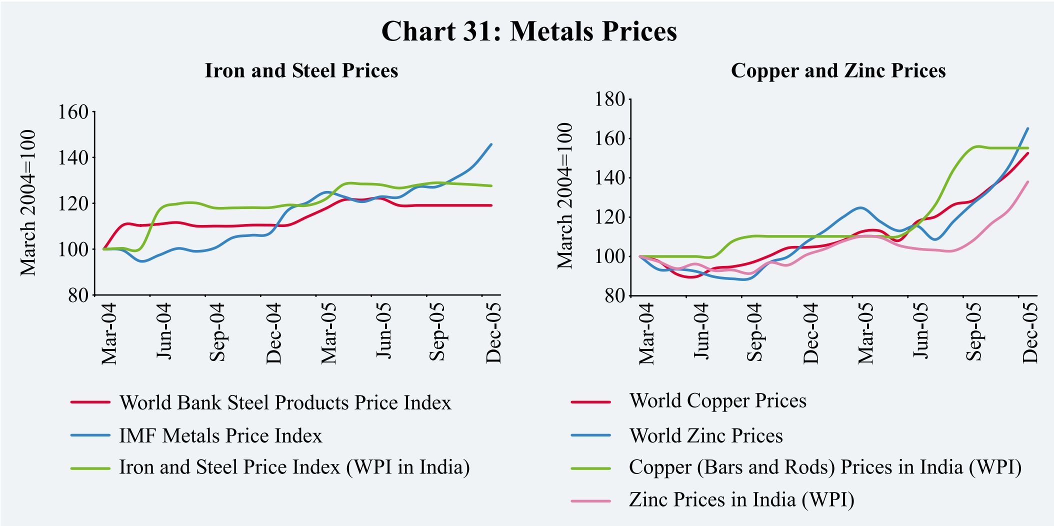
Chart 29: Annual Wholesale Price Inflation



Domestic iron and steel prices eased somewhat during the third quarter of 2005-06 reflecting the recent trends in international steel prices. Prices had increased during the first quarter of 2005-06 but moderated during the second quarter as domestic companies announced cuts/rebates of about 10-12 per cent in prices of select products during June-July 2005 in line with easing trend in international prices and rising inventories. As international prices recovered on the back of production cuts by major global steel producers, domestic companies raised prices again in August 2005. Select product prices eased again thereafter on reports of oversupply in the international markets mainly due to substantial capacity build-up in China. On the whole, iron and steel prices have

Chart 30: Oil Prices



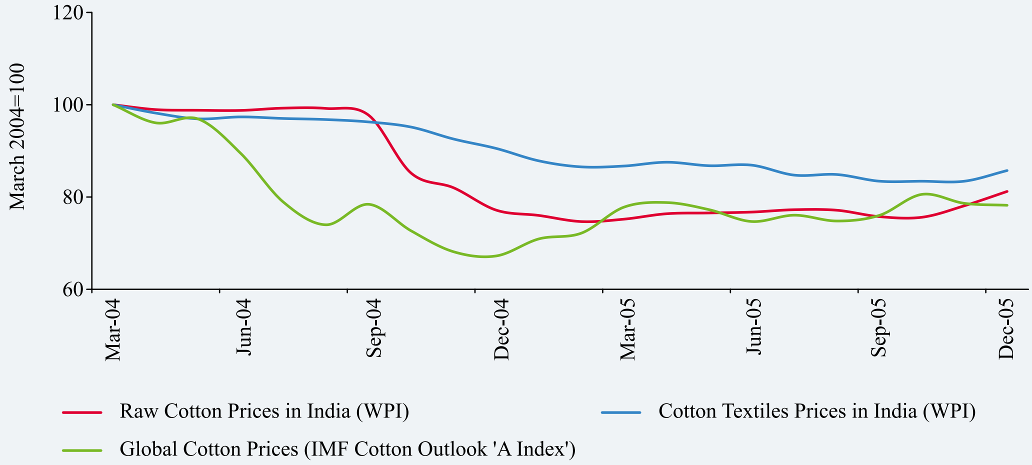


increased by 4.4 per cent during the current financial year up to December 31, 2005 as compared with an increase of 18.7 per cent during the corresponding period of last year. In contrast, prices of non-ferrous metals - copper and zinc - rose sharply. During the fiscal year so far (up to December 31, 2005), prices of copper and zinc have increased by 40.8 per cent and 31.3 per cent, respectively (Chart 31).

Vegetables prices remained high for most part of the third quarter of 2005-06 deviating from the seasonal pattern due to damages to the standing crops from excessive rains/floods in various parts of the country. However, there are signs of moderation since early December 2005. Improved crop prospects are likely to have a soothing effect on food prices in the coming months. Domestic sugar prices continued to remain firm in the third quarter in line with international trends. Although sugarcane output in the country is estimated to be higher during 2005-06, depleting stocks coupled with higher export prices are expected to keep domestic prices firm. Raw cotton prices - which remained flat during the first half of the year - increased during November-December 2005 in tandem with international trends. On the whole, raw cotton prices have increased by 8.4 per cent during the fiscal year so far up to December 31, 2005. Cotton textiles prices, however, declined (Chart 32).

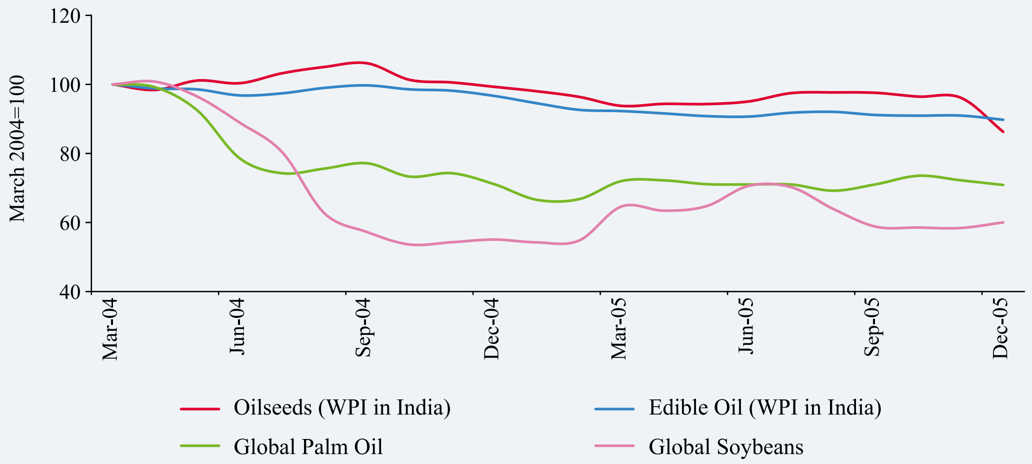
Oilseeds prices have moderated since November 2005 on improved crop prospects. The prices had hardened somewhat during the first half of 2005-06 reflecting last year's shortfall in domestic *kharif* production and worries about a poor ensuing crop due to the unsatisfactory progress of the South-West monsoon. Edible oil prices also declined (Chart 33).

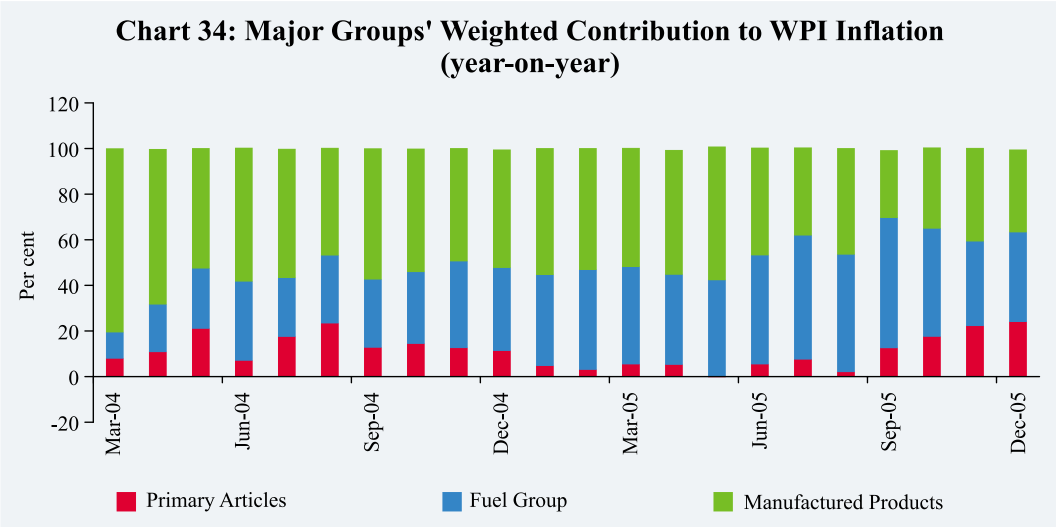
Chart 32: Cotton Prices



In brief, domestic WPI inflation during 2005-06 so far has been dominated by a few items led by mineral oil prices, which alone have contributed over a third of the headline inflation. Accordingly, the contribution of the fuel group to y-o-y overall WPI inflation as on December 31, 2005 was higher at 39.3 per cent (37.1 per cent a year ago). Manufactured products group's contribution decelerated to 36.1 per cent (55.0 per cent) as prices of edible oils, oil cakes and textiles declined. On the other hand, primary articles' contribution to the overall inflation increased mainly due to aberrations in the seasonal behaviour of vegetables prices (Chart 34).

Chart 33: Oilseeds and Edible Oil Prices





Consumer Price Inflation

Consumer price inflation (measured by the CPI for Industrial Workers) during November 2005 increased to 5.3 per cent from 4.2 per cent in March 2005. Other measures of consumer price inflation also edged up in November 2005 reflecting higher food and fuel prices (Table 28).

Disaggregated information on CPI (Industrial Workers) available up to October 2005 shows firming up of food prices from the March 2005 level. Services inflation - proxied by the miscellaneous group in the CPI-IW - edged up reflecting increase in the prices of education and recreation. 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 29).

Table 28: Consumer Price Inflation (CPI) in India (year-on-year)

(Per cent)

Inflation Measure	March 2003	March 2004	November 2004	March 2005	June 2005	September 2005	October 2005	November 2005
1	2	3	4	5	6	7	8	9
CPI-IW	4.1	3.5	4.2	4.2	3.3	3.6	4.2	5.3
CPI- UNME	3.8	3.4	4.0	4.0	3.9	4.8	4.5	5.5
CPI-AL	4.9	2.5	3.3	2.4	2.7	3.2	3.2	4.7
CPI-RL	4.8	2.5	3.3	2.4	2.7	3.2	3.2	4.6
Memo:								
WPI Inflation (end period)	6.5	4.6	7.3	5.1	4.3	4.3	4.8	4.5

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

Table 29: Consumer Price Inflation for Industrial Workers (year-on-year)

(Per cent)

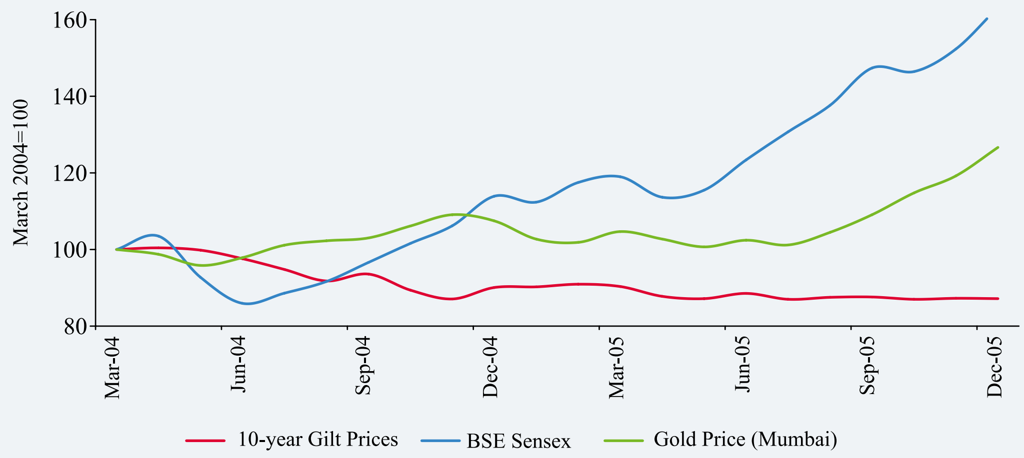
Commodity		March 2005		October 2004		October 2005	
	Weight	Inflation	WC	Inflation	WC	Inflation	WC
1	2	3	4	5	6	7	8
General Index	**100.0**	**4.2**	**100.0**	**4.6**	**100.0**	**4.2**	**100.0**
1. Food Group	**57.0**	**1.6**	**21.7**	**3.4**	42.1	**4.1**	**54.4**
i. Cereals and Products	20.5	0.7	2.9	-0.2	-0.9	2.6	11.2
ii. Pulses and Products	3.6	-2.0	-1.9	6.2	5.3	5.3	5.1
iii. Oils and Fats	5.0	-7.1	-6.9	0.8	0.7	-4.8	-4.3
iv. Meat, Fish and Eggs	4.3	5.0	6.3	6.9	7.5	6.4	7.8
v. Milk and Products	6.5	1.7	2.5	3.1	3.9	1.7	2.3
vi. Condiments and Spices	3.2	-9.0	-7.6	-4.6	-3.7	15.6	12.6
vii. Vegetables and Fruits	5.7	6.5	8.2	12.9	17.6	3.4	5.5
viii. Other Foods	8.3	7.8	17.7	6.0	12.2	5.8	13.2
2. Pan, Supari, Tobacco and Intoxicants	**3.2**	**2.1**	**2.1**	**3.0**	**2.7**	**1.8**	**1.7**
3. Fuel and Light	**6.3**	**4.9**	**8.7**	**10.0**	**15.3**	**-5.5**	**-9.7**
4. Housing	**8.7**	**20.4**	**50.0**	**11.7**	**25.6**	**11.7**	**30.0**
5. Clothing, Bedding and Footwear	**8.5**	**2.3**	**3.3**	**2.7**	**3.3**	**2.6**	**3.5**
6. Miscellaneous Group (Services)	**16.4**	**3.9**	**15.6**	**3.6**	**12.8**	**4.2**	**16.4**
i. Medical Care	2.6	4.4	3.2	5.4	3.5	2.7	1.9
ii. Education and Recreation	3.1	5.1	3.4	3.8	2.3	6.9	4.6
iii. Transport and Communication	2.7	6.8	5.0	3.2	2.2	6.9	5.1
iv. Personal Care and Effects	3.3	3.2	2.5	4.1	2.9	2.6	2.0
v. Others	4.7	1.7	1.8	1.7	1.6	2.9	3.0

WC: Weighted Contribution.

Asset Prices

Equity and gold prices recorded sharp increases during the quarter ended December 2005. Buoyancy in equity markets continued on the back of corporate performance, continued liquidity support by FIIs and better prospects for economic activity (Chart 35). Corporate profitability remains strong and profits

Chart 35: Asset Price Movements



after tax have increased by 41.3 per cent during April-September 2005. Domestic gold prices remained firm in line with international trends. International gold prices have risen sharply since mid-2005 - crossing US $ 550 per ounce in mid-January 2006 - as investors preferred gold in an environment of higher headline inflation. Higher demand for gold was also influenced by renewed interest by hedge funds who switched to gold away from oil on the back of forecasts about some slowdown in global oil demand. Gilt prices have been largely range bound since May 2005 with intra-year movements influenced by trends in domestic inflation and liquidity conditions.

V. FINANCIAL MARKETS

During the third quarter (October-December) of 2005-06, international financial market conditions generally continued to remain favourable. Equity markets remained buoyant on expectations of improved growth prospects, notwithstanding some increase in long-term rates in major economies. Short-term interest rates moved up in a number of economies as monetary policy was further tightened due to firming up of inflationary pressures emanating from higher energy prices. Consequently, long-term yields edged higher during the quarter ended December 2005 as investors revised upwards their expectations regarding future policy rates. Financing conditions in emerging market economies (EMEs) also remained favourable reflecting improved economic fundamentals.

Short-term rates increased by 35 basis points in the Euro area and by 60 basis points in the US between end-September 2005 and January 11, 2006. Amongst EMEs, short-term rates increased by more than 50 basis points in Argentina, India, Singapore and Thailand. The US Federal Reserve raised Federal Funds target rate by 25 basis points for the 13th consecutive time to 4.25 per cent on December 13, 2005. The European Central Bank (ECB) also hiked its key policy rate by 25 basis points to 2.25 per cent on December 1, 2005 after having held it unchanged since June 6, 2003 (Table 30).

Table 30: Short-term Interest Rates

(Per cent)

Country	March 2004	March 2005	June 2005	September 2005	January 2006#
1	2	3	4	5	6
Advanced Economies					
Euro Area	1.96	2.15	2.10	2.15	2.50
Japan	0.03	0.02	0.02	0.02	0.03
Sweden	2.12	1.97	1.48	1.46	1.84
UK	4.31	4.95	4.75	4.56	4.56
US	1.04	2.90	3.33	3.85	4.45
Emerging Market Economies					
Argentina	2.88	4.56	6.94	6.69	8.88
Brazil	16.02	19.25	19.74	19.51	17.95
China	N.A.	2.25	2.30	4.38	2.18
Hong Kong	0.17	2.79	3.36	4.12	4.08
India	**4.24**	**5.37**	**5.37**	**5.49**	**6.19**
Malaysia	3.00	2.82	2.87	2.92	3.25
Philippines	9.19	7.25	5.88	8.13	6.75
Singapore	0.69	2.06	2.06	2.34	3.28
South Korea	3.90	3.54	3.52	3.94	4.17
Thailand	1.31	2.64	2.75	3.90	4.50

N.A. : Not available. # : As on January 11, 2006.

Note : Data for India refer to 91-day Treasury Bills rate and for other countries 3-month money market rates.

Source : The Economist.

Long-term Government bond yields increased during October 2005 reversing the softening trend during the first half of the year. Yields had initially declined during April-June 2005 on expectations that monetary authorities could slow down policy tightening due to fragility in the economic recovery. 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. The US 10-year Treasury yield was at a 14-month low at 3.8 per cent in early-June 2005. During July 2005, yields, however, firmed up in the run up to the widely anticipated revaluation of the Chinese currency on July 21, 2005. With the Chinese authorities continuing to manage the renminbi tightly, the yields reversed their increasing trend. Long-term Government bond yields increased during October 2005 in the US and Euro area in tandem with sharp rise in headline inflation and higher short-term rates which increased expectations regarding future policy rates. In December 2005, 10-year yields eased again. Yield on 10-year US treasuries briefly fell below that on two-year treasuries in end-December 2005 for the first time in the past five years (Chart 36). In the Euro area and Japan, the increase in long-term yields was also on account of improved economic outlook. In the UK, the yields remained almost range-bound reflecting weak growth prospects.

Equity markets in many economies continued to exhibit buoyancy during the third quarter of 2005-06, notwithstanding some increase in long-term interest rates. In the wake of sharp increase in inflation during September 2005 and the prospects of faster pace of monetary tightening, equity prices declined in October 2005 around the world. Equity markets, however, bounced back in November 2005 on signs of robust economic activity in the US. Equity markets were also buoyed by some moderation in international crude oil prices from their record

Chart 36: Interest Rates – Advanced Economies

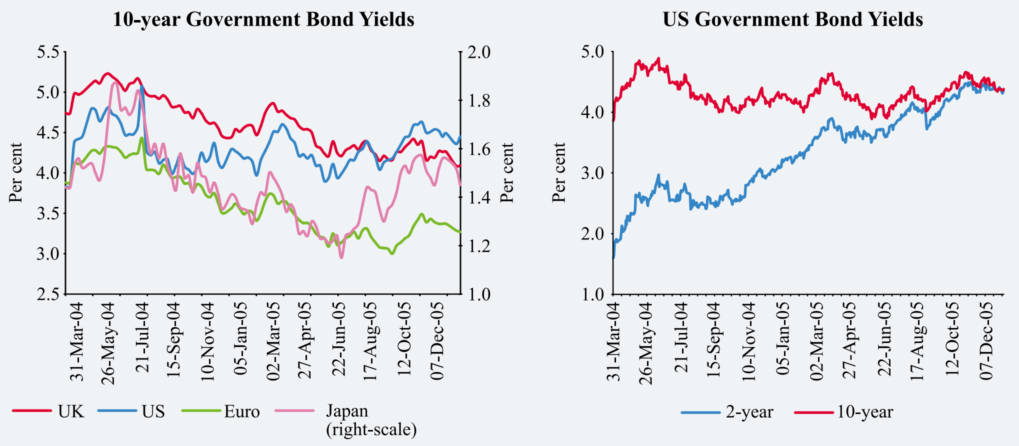
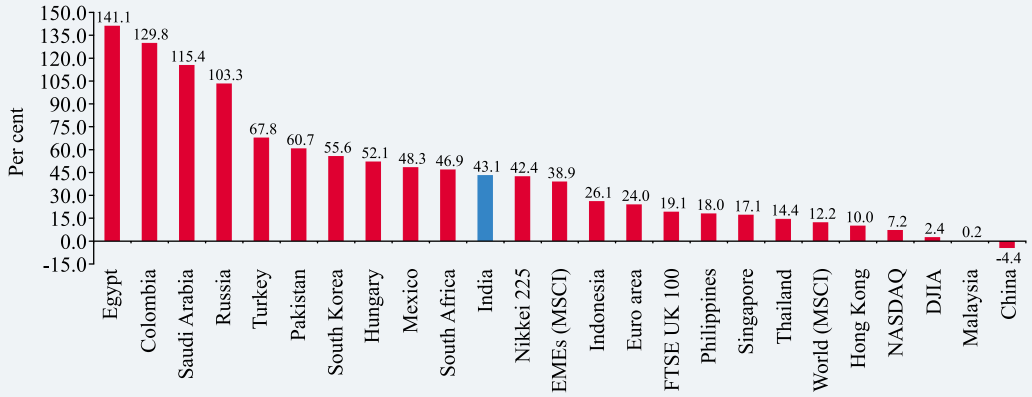


Chart 37: International Stock Markets

(Percentage Change between December 31, 2004 and January 11, 2006)

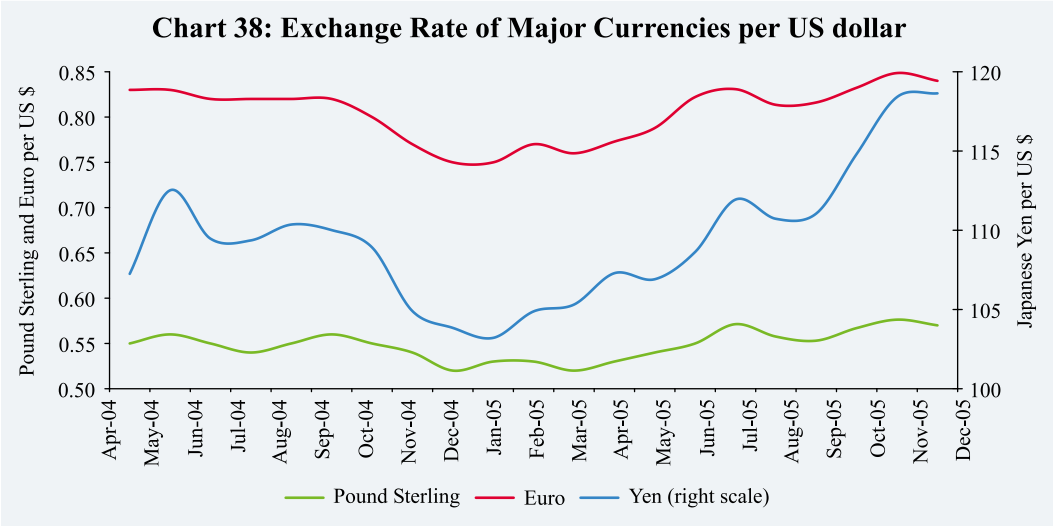


Source : The Economist.

highs. During 2005, stock markets in India outperformed major Asian markets (Chart 37). Stock markets in some emerging markets outside Asia yielded even higher returns led by Egypt (141.1 per cent since end-December 2004) followed by Colombia, Saudi Arabia, Russia and Turkey. Equity markets in the US, however, under-performed significantly as equities struggled to cope with the impact of higher US interest rates and increasing activity by US investors in overseas markets. Equity markets in the Euro area registered relatively better returns reflecting improved economic outlook.

Notwithstanding the growing current account deficit, the US dollar appreciated further against major currencies during the third quarter of 2005-06 (2.6 per cent against the Euro, 2.1 per cent against the Pound Sterling and 4.3 per cent against the Yen), reflecting growing interest and growth differential in favour of the US (Chart 38). The US dollar also benefited from a year-long tax break designed to encourage US multinationals to repatriate cash held overseas. The US dollar, however, has depreciated since mid-December 2005 on anticipation that the monetary tightening in the US might be nearing its end.

Indian financial markets have remained broadly stable during 2005-06 so far. During the quarter, the redemption of India Millennium Deposits (IMDs) (December 29, 2005) took place smoothly although the markets witnessed some liquidity pressures during November-December 2005. The Reserve Bank put in place arrangements for redemption of IMDs in close co-ordination with the State Bank of India (SBI). Appropriate preparations and arrangements were made to ensure that the redemption is done smoothly, in time and without causing any impact on the money, Government securities and foreign exchange markets.



Comfortable liquidity kept money market segments generally around the reverse repo rate during April-October 2005. During most part of November-December 2005, however, the call money rate remained above the reverse repo rate reflecting some liquidity pressures. 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 largely remained range bound since then. In the credit market, deposit and lending rates edged up during the quarter ended December 2005. The primary market 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 crossing 9000 in December 2005 (Table 31).

Money Market

Money markets during 2005-06 till October 2005 were largely 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 capital 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

Table 31: Domestic Financial Markets at a Glance

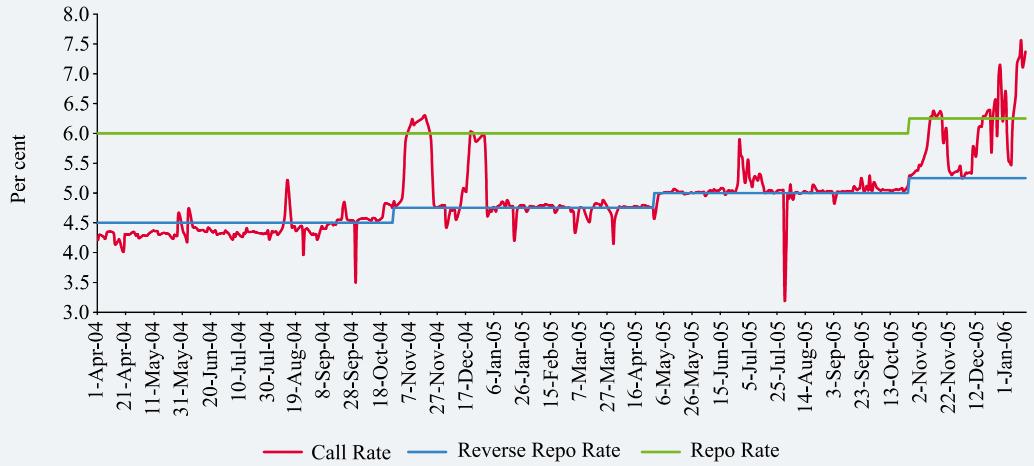
Month	Call Money		Govt. Securities		Foreign Exchange				Liquidity Management		Equity			
	Average Daily Turnover (Rs. crore)	Average Call Rates* (Per cent)	Average 10-Year Yield@ (Per cent)	Average Daily Turnover (Rs. crore)+	Average Daily Inter-bank Turnover (US $ million)	Average Exchange Rate (Rs. per US $)	RBI's net Foreign Currency Sales(-)/ Purchases (+) (US $ million)	Average Forward Premia 3-month (Per cent)	Average MSS Out-standing# (Rs. crore)	Average Daily Reverse Repo (LAF) Out-standing (Rs. crore)	Average Daily BSE Turnover (Rs. crore)	Average Daily NSE Turnover (Rs. crore)	Average BSE Sensex**	Average S&P CNX Nifty**
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
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	10,988	4.30	5.19	6,202	8,882	45.25	-220	-1.33	27,518	74,502	2,188	4,710	5205	1640
June	10,974	4.35	5.50	5,860	7,847	45.51	-413	0.93	35,283	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	16,666	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	19,526	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	15,294	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	20,134	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	0	0.62	67,617	31,570	3,871	6,923	8272	2512
October	17,164	5.12	7.14	2,815	10,802 P	44.82	0	0.69	68,602	18,608	2,955	6,040	8220	2487
November	22,620	5.79	7.10	3,314	11,001 P	45.73	0	0.67	67,041	3,268	2,635	5,480	8552	2575
December	21,149	6.00	7.13	2,948	13,632 P	45.64	N.A.	1.51	52,040	1,452	3,516	6,814	9162	2773

* : 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.
P : Provisional.
LAF : Liquidity Adjustment Facility.
NSE : National Stock Exchange of India Ltd.
N.A. : Not Available.

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. Liquidity conditions improved by the second half of July 2005 due to cancellation of some scheduled Treasury Bills auctions and increase in Government spending. 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 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. For the most part of October 2005, the call money rate hovered around the reverse repo rate as liquidity conditions remained easy (Chart 39).

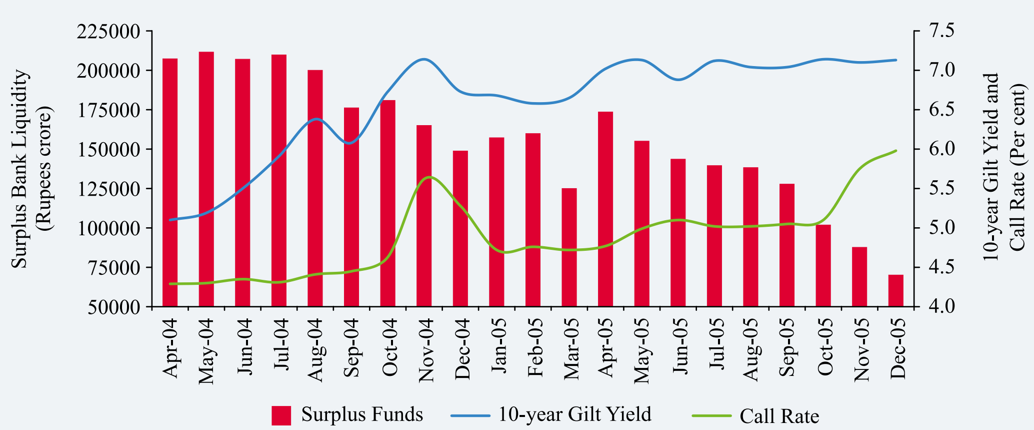
During November 2005, the call money rate remained generally above the reverse repo rate and also exceeded the repo rate on a few occasions reflecting

Chart 39: Call Rate and the Reverse Repo Rate



liquidity pressures emanating from sustained credit demand, festival demand for currency and scheduled auctions (Chart 40). The Reserve Bank, therefore, injected liquidity into the system through LAF repos on seven occasions during the month. Concomitantly, the notified amount of Treasury Bills auctions under the MSS was also cancelled. The call money rate subsequently hovered around the reverse repo rate. To fine-tune the management of liquidity and in response to suggestions from the market participants, the Reserve Bank introduced a Second Liquidity Adjustment Facility (SLAF), with effect from November 28, 2005. Beginning the second half of December 2005, call money rate again edged up as the market witnessed large liquidity pressures emanating from credit offtake and

Chart 40: Surplus Bank Liquidity and Interest Rates



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

quarter-end advance tax payments amidst uncertainty relating to the redemption of the IMDs. The call money rate eased during the first week of January 2006 with the smooth redemption of IMDs and reduction in the Centre's surplus balances. The call money rate, however, increased during the second week of January 2006 reflecting demand pressures emanating from scheduled auctions of Government securities.

The turnover in the collateralised segments of the money market – the market repo (outside the LAF) and the Collateralised Borrowing and Lending Obligation (CBLO) segments which provide funds at a lower cost – continued to expand during the quarter ended December 2005. Interest rates in the various segments edged up during the third quarter reflecting liquidity conditions (Chart 41). 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 141 in December 2005. On the other hand, 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 32). The increase in turnover during June-July 2005 and November-December 2005 reflected increased recourse to call money market due to liquidity pressures.

Other Money Market Instruments

Issuances under commercial paper (CP) which had exhibited increases till mid-September 2005 witnessed some moderation in the quarter ended December 2005 reflecting tight liquidity conditions. Accordingly, outstanding

Chart 41: Interest Rates in Money Markets

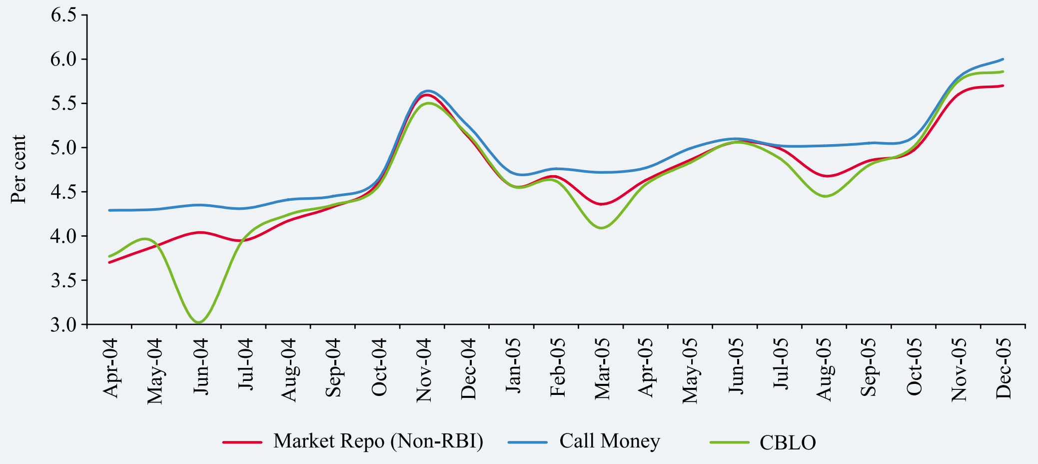


Table 32: Activity in Money Market Segments

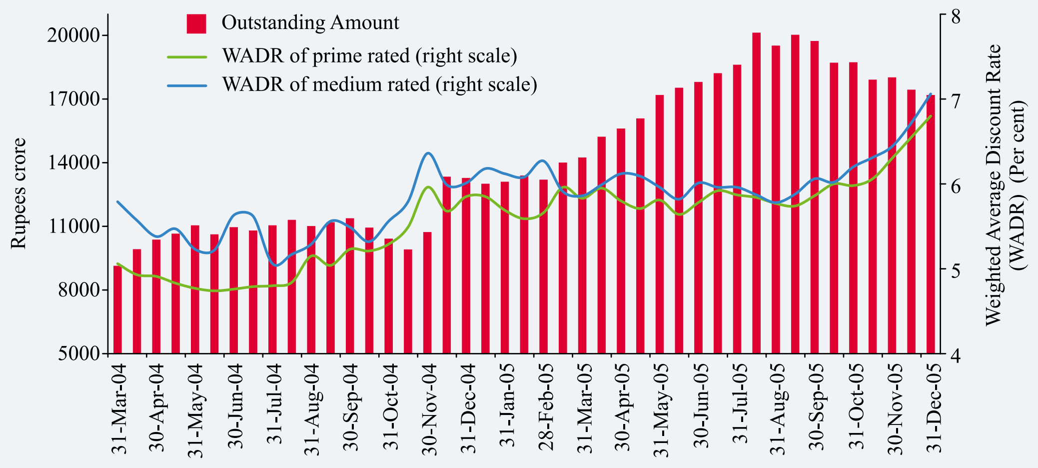
(Rupees crore)

Month	Average Daily Turnover: Call Money Market	Average Daily Turnover: Term Money Market	Average Daily Turnover: Repo Market (Outside the LAF)	Average Daily Turnover: Collateralised Borrowing and Lending Obligation (CBLO)	Outstanding Amount: Commercial Paper	Outstanding Amount: Certificates of Deposit	Forward Rate Agreements/ Interest Rate Swaps (Notional Amount)
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	10,988	372	15,932	3,872	11,038	4,860	6,11,595
June	10,974	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	8,53,195
October	16,666	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	19,526	504	21,922	9,962	13,272	6,103	9,75,135
January	16,534	514	17,556	7,701	13,092	4,236	10,14,442
February	16,041	878	17,562	8,952	13,189	9,214	9,46,293
March	15,294	1,253	14,688	9,626	14,235	12,078	10,62,242
2005-06							
April	17,213	661	12,174	10,370	15,598	16,602	10,76,513
May	15,269	545	13,688	12,233	17,182	17,689	10,72,684
June	20,134	534	17,163	11,792	17,797	19,270	10,93,367
July	20,046	717	18,103	15,292	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	27,641	13,17,829
October	17,164	734	20,980	21,763	18,723	29,193	13,42,335#
November	22,620	917	25,660	20,496	18,013	27,457	N.A.
December	21,149	775	25,574	21,265	17,180	30,445*	N.A.

*: As on December 9, 2005. #: As on October 14, 2005. N.A. : Not available.

CPs after increasing from Rs.14,235 crore at end-March 2005 to Rs. 20,019 crore by mid-September 2005 fell to Rs.17,180 crore by end-December 2005 (Chart 42).

Chart 42: Commercial Paper Market



Concomitantly, the weighted average discount rate (WADR) on CPs increased to 6.81 per cent on December 31, 2005 from 5.81 per cent on March 31, 2005. Leasing and finance companies continue to be the largest issuers of CPs – a share of 65.1 per cent in amount outstanding as on December 31, 2005 – partly reflecting the policy of phasing out the access of these companies to public deposits. Manufacturing and other companies and financial institutions are the other issuers with shares of 29.8 per cent and 5.1 per cent, respectively, as on December 31, 2005.

The market for certificates of deposit (CDs) has 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 amount of CDs outstanding doubled from Rs.14,975 crore in early April 2005 to Rs.30,445 crore by December 9, 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 3.0 per cent of aggregate deposits of issuing banks as on December 9, 2005, up from 2.0 per cent a year ago. The typical three-month discount rate on CDs at 6.50 per cent on December 9, 2005 was higher by about 60 basis points over its level at end-March 2005 (Chart 43). 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 32).

Chart 43: Certificates of Deposit Market

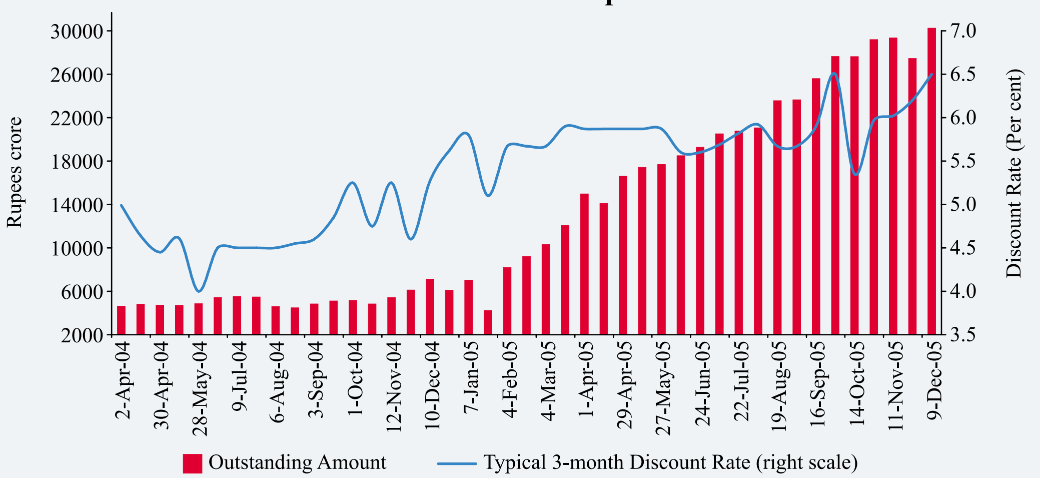


Table 33: Treasury Bills in the Primary Market

Month	Notified Amount (Rs. crore)	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	8
2004-05							
April	13,500	4.38		4.44	2.15		2.47
May	12,000	4.39		4.33	2.93		2.46
June	14,000	4.44		4.55	2.61		1.28
July	10,000	4.46		4.60	2.39		2.06
August	10,000	4.76		5.00	1.81		3.36
September	12,000	4.72		5.14	2.51		2.83
October	16,000	5.15		5.46	1.82		2.75
November	5,500	5.47		5.71	2.80		2.64
December	9,500	5.30		5.69	2.69		2.81
January	12,000	5.31		5.69	2.19		2.06
February	12,000	5.25		5.65	2.99		2.81
March	12,000	5.24		5.63	2.31		2.74
2005-06							
April	19,000	5.17	5.36	5.62	4.03	4.48	2.54
May	15,000	5.19	5.35	5.58	3.30	3.37	2.29
June	18,000	5.29	5.37	5.61	1.54	2.42	1.81
July	11,500	5.46	5.67	5.81	1.21	2.58	1.68
August	21,000	5.23	5.42	5.63	3.07	2.68	2.54
September	23,000	5.24	5.37	5.70	1.52	1.45	1.61
October	15,000	5.50	5.71	5.84	1.69	1.53	3.44
November	11,000	5.76	5.87	5.96	2.12	1.97	2.30
December	5,000	5.89	6.04	6.09	3.07	2.97	2.36

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

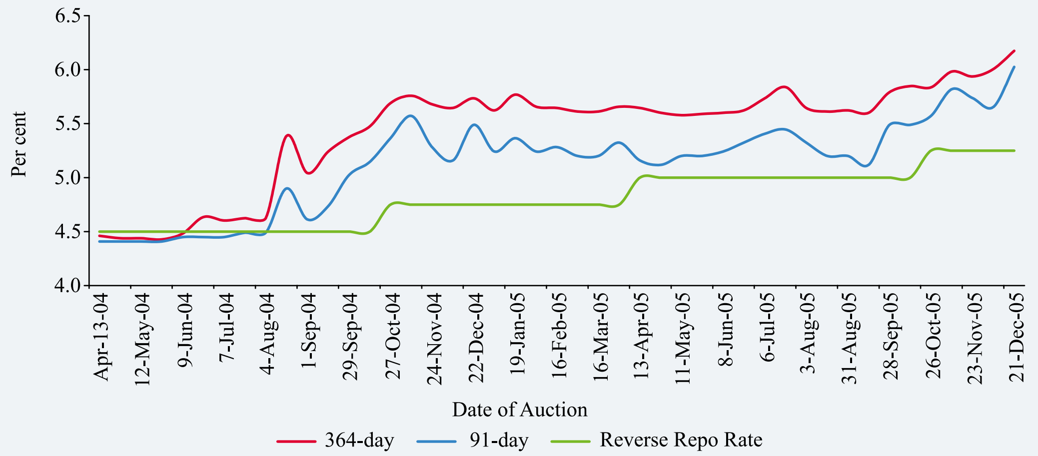
Treasury Bills

Yields in Treasury Bill (TB) auctions increased during October-December 2005, reflecting tight liquidity conditions (Table 33). In view of liquidity conditions, the Reserve Bank rejected all the bids for the TB auctions under the MSS scheduled on November 9, 2005 and reduced the notified amount in subsequent auctions by discontinuing absorption under the MSS, effective November 16, 2005. Yields in December 2005 were 39-67 basis points higher over their September 2005 levels and 46-68 basis points higher over their March 2005 levels. The average yield spread between the 91-day and 364-day TBs at 20 basis points in December 2005 was lower than the March 2005 level (39 basis points) (Chart 44).

Foreign Exchange Market

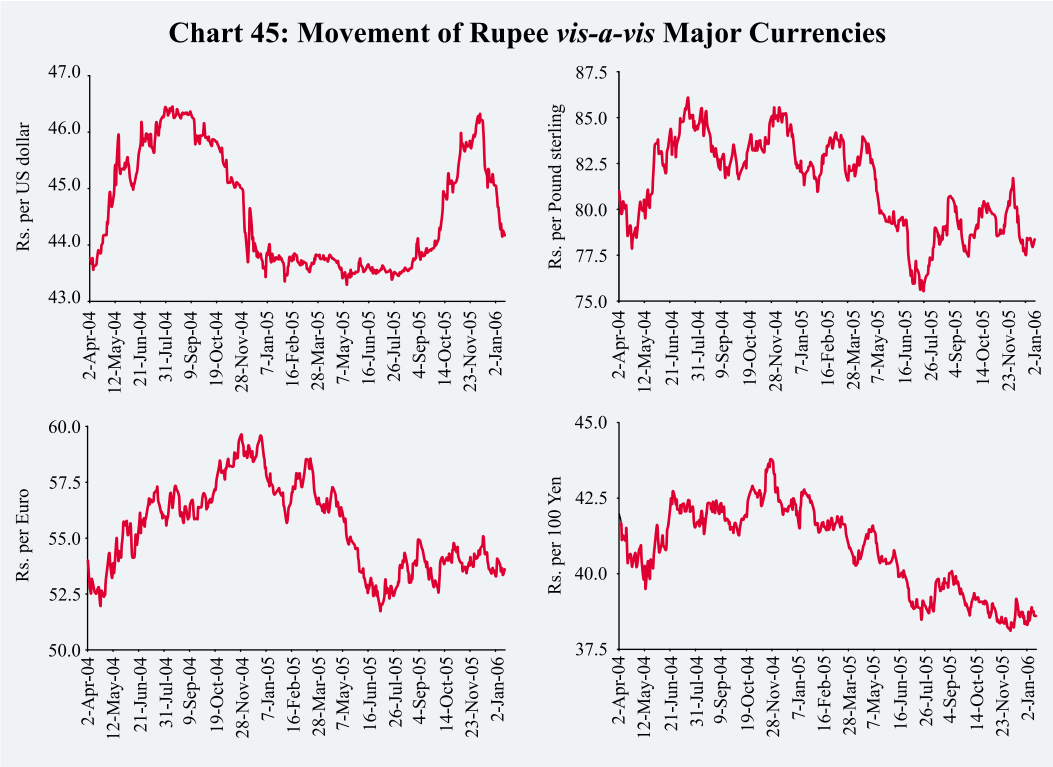
In the foreign exchange market, the Indian rupee exhibited two-way movements *vis-à-vis* the US dollar during the third quarter of 2005-06: depreciation during October to mid-December 2005 and appreciation since then. On the whole, the rupee depreciated by 2.4 per cent *vis-à-vis* the dollar during

Chart 44: Yields on Treasury Bills



the third quarter of 2005-06. The rupee has moved in a range of Rs.43.30–46.33 per US dollar during 2005-06 so far (up to January 18, 2006). 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, despite outflows by FIIs and a higher merchandise trade deficit. 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 renminbi 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. The rupee faced further pressure in the first week of October 2005 in the face of sharp increase in the current account deficit and strong US dollar. The pressures continued till the first half of December 2005 and the rupee reached Rs.46.33 per US dollar on December 8, 2005. With the revival of FII inflows and weakening of the US dollar in the international markets, the rupee strengthened in the second half of December 2005. The exchange rate stood at Rs.44.48 per US dollar on January 18, 2006. At this level, the Indian rupee has depreciated by 1.6 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 (5.2 per cent), the Pound sterling (4.8 per cent) and the Japanese yen (6.1 per cent) (Chart 45).

Forward premia increased during December 2005 reflecting higher domestic call money rates. Premia had declined during the first half of 2005-06 in tandem with narrowing interest differential following the hikes in the US interest rates (Chart 46).



The turnover in the foreign exchange market (both merchant and inter-bank) increased during the quarter from US $ 292.8 billion in September 2005 to US $ 418.8 billion in December 2005 (Chart 47).

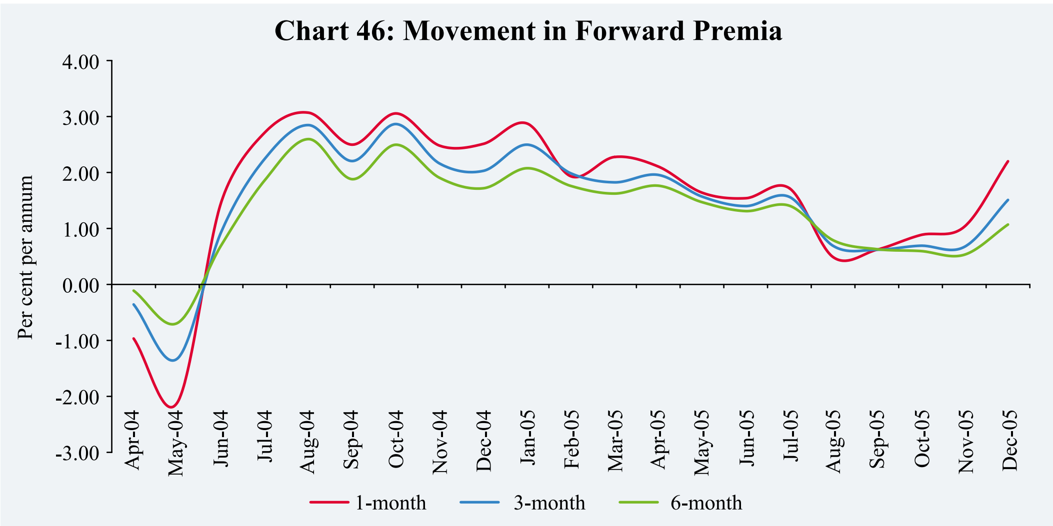
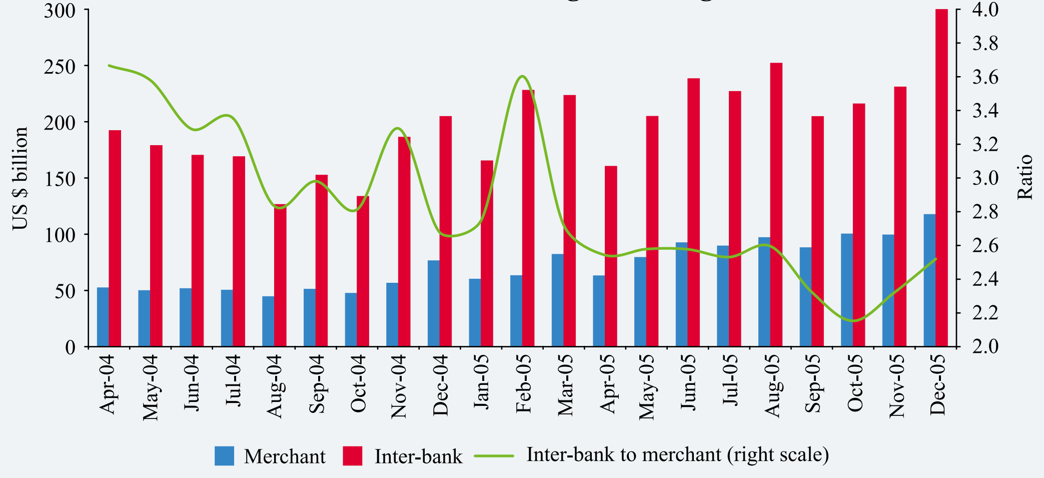


Chart 47: Turnover in Foreign Exchange Market



Credit Market

The demand for credit from the commercial sector remained strong during the third quarter of 2005-06 (Chart 48). As on January 6, 2006, the non-food credit extended by scheduled commercial banks grew, year-on-year, by 32.0 per cent on top of 26.6 per cent growth a year ago (net of conversion). Food credit growth recorded a deceleration over its end-March 2005 level on account of lower procurement.

Demand for bank credit has been broad-based led by agriculture, industry and housing (Table 34). The increase in industrial credit was mainly on account

Chart 48: Non-food Credit and Industrial Production

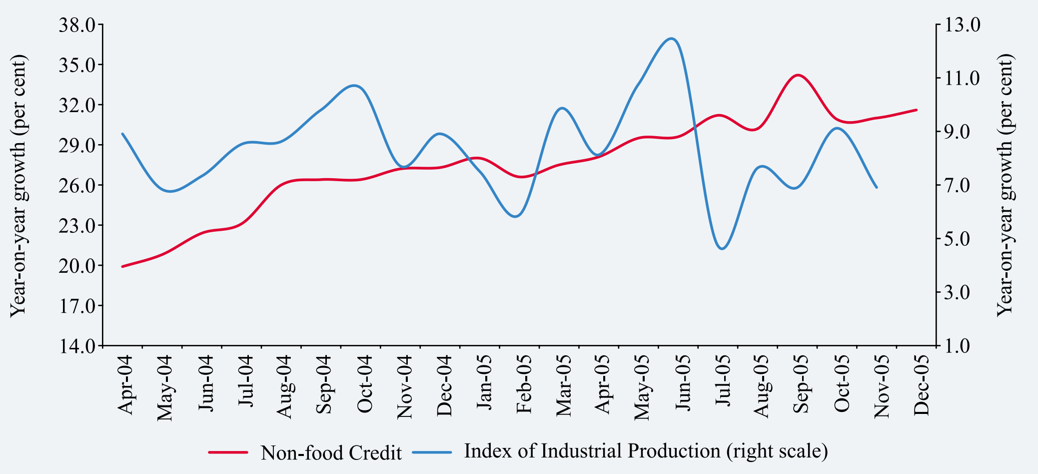


Table 34: Deployment of Non-food Bank Credit

(Amount in Rupees crore)

Sector/Industry	Outstanding as on October 28, 2005	Financial Year Variations			
		Apr-Oct 2004		Apr-Oct 2005	
		Absolute	Per cent	Absolute	Per cent
1	2	3	4	5	6
Non-food Gross Bank Credit	**11,57,769**	**92,054**	**12.6**	**1,57,981**	**15.8**
of which					
Agriculture and Allied Activities	1,41,612	11,267	12.4	16,362	13.1
Industry (Small, Medium and Large)	4,75,915	26,738	8.5	49,023	11.5
Small Scale Industries	78,780	1,322	2.0	4,192	5.6
Trade	69,315	7,580	30.5	11,367	19.6
Housing	1,53,267	N.A.	N.A.	24,539	19.1
Advances against Fixed Deposits	30,283	-651	-2.5	433	1.5
Other Sectors	1,40,082	46,469	15.5	26,048	22.8
Real Estate Loans	20,148	2,663	47.7	6,846	51.5
Non-Banking Financial Companies	25,672	604	3.6	3,188	14.2
Memo:					
Priority Sector	4,33,422	26,181	9.9	51,946	13.6
Industry (Small, Medium and Large)	4,75,915	26,738	8.5	49,023	11.5
Food Processing	26,259	-361	-1.7	1,826	7.5
Textiles	48,229	-44	-0.1	4,252	9.7
Paper & Paper Products	7,910	181	3.0	1,028	14.9
Petroleum, Coal Products & Nuclear Fuels	20,549	3,533	28.8	4,980	32.0
Chemical and Chemical Products	40,723	-847	-2.8	1,231	3.1
Rubber, Plastic & their Products	5,596	249	9.6	1,930	52.6
Iron and Steel	42,138	10	0	6,137	17.0
Other Metal & Metal Products	13,968	1,006	12.3	2,332	20.0
Engineering	32,694	-1,033	-3.9	3,298	11.2
Vehicles, Vehicle Parts and Transport Equipments	15,825	262	4.9	3,963	33.4
Gems & Jewellery	17,880	2,323	25.3	3,574	25.0
Construction	10,726	1,716	28.7	2,604	32.1
Infrastructure	96,639	14,169	27.6	17,630	22.3

N.A. : Not Available.

Note : 1. 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.

2. Due to change in classification of sectors/industries and coverage of banks, data for 2005-06 are not comparable with earlier data.

of infrastructure (*viz*., power and telecommunications), textiles, petroleum, iron and steel, gems and jewellery, engineering, vehicles, rubber and plastic products, and construction. Credit to agriculture recorded a strong growth reflecting various policy initiatives to improve the flow of credit to the sector. Strong demand for credit to the housing sector benefited from low interest rates and tax incentives. Credit to the commercial real estate continued to increase sharply.

During the third quarter, deposit rates increased by 25-100 basis points across various maturities (Table 35). As regards lending rates, while the

Table 35: Movements in Deposit and Lending Rates

(Per cent)

Interest Rate	March 2004	March 2005	June 2005	September 2005	December 2005
1	2	3	4	5	6
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	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	5.50-6.50
More than 3 years	5.25-6.00	5.25-7.00	5.50-6.50	5.50-6.00	5.80-7.00
Private Sector Banks					
Up to 1 year	3.00-6.00	3.00-6.25	3.00-6.25	3.00-6.25	3.50-6.25
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	5.50-7.00
More than 3 years	5.25-7.00	5.75-7.00	5.50-7.25	5.75-7.25	6.00-7.25
Foreign Banks					
Up to 1 year	2.75-7.75	3.00-6.25	3.00-5.50	3.00-5.75	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	4.25-6.00
More than 3 years	3.25.800	3.50-7.00	4.00-7.00	4.00-7.00	5.00-7.00
2. Benchmark Prime Lending Rate					
Public Sector Banks	10.25-11.50	10.25-11.25	10.25-11.25	10.25-11.25	10.25-11.25
Private Sector Banks	10.50-13.00	11.00-13.50	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	10.00-14.50
3. Actual Lending Rate*					
Public Sector Banks	4.00-16.00	2.75-16.00	3.35-16.50	4.00-15.50	N.A.
Private Sector Banks	4.50-22.00	3.15-22.00	3.15-24.94	4.00-20.00	N.A.
Foreign Banks	3.75-23.00	3.55-23.50	4.00-25.00	2.85-25.00	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.

Benchmark Prime Lending Rates (BPLRs) remained unchanged, banks revised upwards their sub-BPLRs.

Government Securities Market

Yields in the Government securities market moved in a narrow range during the third quarter of 2005-06, continuing with the trend witnessed since May 2005. Intra-year movements in yields have been 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 from 6.65 per cent on March 31, 2005 to 7.31 per cent on April 30, 2005. With the easing of headline WPI inflation, yields softened during May 2005 touching 6.94 per cent in early June 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 an increase in the reverse repo rate. 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. The yields remained broadly stable hovering at around seven per cent during August-September 2005. In October 2005, the yields increased marginally in anticipation of hike in the repo/reverse repo rates in the Mid-Term Review of Annual Policy Statement on October 25, 2005. Despite increases in the repo and reverse repo rates by 25 basis points, the yields fell marginally due to some moderation in international crude oil prices and easing of headline inflation.

Although money markets were marked by liquidity tightness during November-December 2005, yields in the Government securities market remained range bound as domestic inflation and inflation expectations remained well-contained, aided by a moderation in international crude oil prices. The yields on 10-Year Government securities moved in a range of 7.06 - 7.18 per cent during the quarter ended December 2005. The 10-year yield stood at 7.11 per cent on January 18, 2006, one basis point lower than its end-September 2005 level and 46 basis points higher than its end-March 2005 level. The spread between 1-year and 10-year yields narrowed to 91 basis points at end-December 2005 (from 114 basis points at end-March) and that between 10-year and 30-year yields narrowed to 34 basis points (from 54 basis points at end-March) (Chart 49).

The yield on 5-year AAA-rated corporate bonds increased by 32 basis points during the quarter ended December 2005. The yield spread over 5-year Government securities increased to 65 basis points at end-December 2005 from 28 basis points at end-September 2005 but was almost unchanged from that at end-March 2005 (67 basis points) (Chart 50).

Chart 49: Yields on Central Government Securities

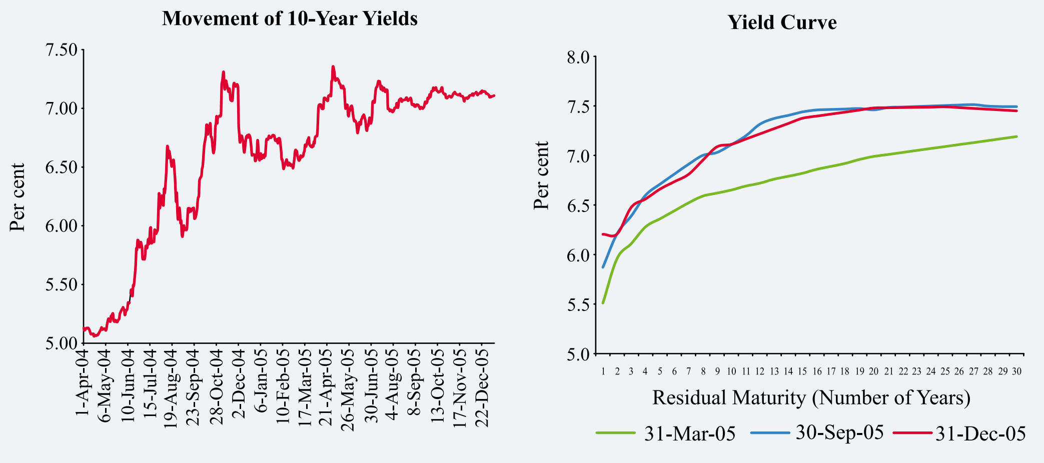
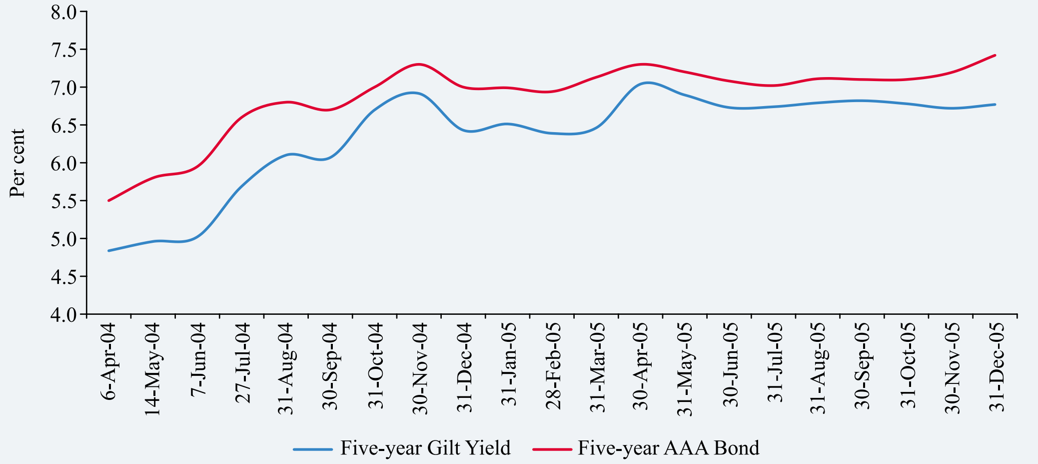


Chart 50: Yield Spreads



Equity Market

Capital markets continued to exhibit buoyancy during the third quarter of 2005-06. Resources raised by Indian corporates through initial public offerings and Euro issues increased further during October-December 2005, driven by bullish trend in the secondary market, robust macroeconomic fundamentals, congenial investment climate and sound business outlook. Indian stock markets touched historical high levels during December 2005. Satisfactory progress of the monsoon, robust industrial growth combined with satisfactory first half 2005-06 financial results of the corporates, strong investments by FIIs and mutual funds and firm trends in international stock markets enthused the market sentiment. On a point-to-point basis, the BSE Sensex increased by 8.8 per cent during the third quarter of 2005-06.

Primary Market

Resources raised through the public issues segment increased by 60.9 per cent during April-December 2005 (Table 36). With the number of public issues more than doubling during April-December 2005, average size of public issues, however, came down to Rs.214 crore during April-December 2005 from Rs.301 crore during the corresponding period of the previous year. Non-Government public limited companies (private sector) accounted for the bulk (86.6 per cent) of resources mobilised by way of public issues during April-December 2005. Three public sector banks raised equity worth Rs.2,520 crore during April-December 2005. Out of 88 issues during April-December 2005, 47 issues were initial public offerings (IPOs), constituting 47.6 per cent of resource mobilisation as compared with 17 out of 39 issues being IPOs during the corresponding period of the last

Table 36: Mobilisation of Resources from the Primary Market

(Amount in Rupees crore)

Item	April-December 2004		April-December 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)	**38**	**9,041**	**85**	**16,351**
a) Financial	6	3,755	6	6,982
b) Non-financial	32	5,286	79	9,369
2. Public Sector (a+b+c)	**1**	**2,684**	**3**	**2,520**
a) Public Sector Undertakings	–	–	–	–
b) Government Companies	1	2,684	–	–
c) Banks/Financial Institutions	–	–	3	2,520
3. Total (1+2)	**39**	**11,725**	**88**	**18,871**
Of which:				
(i) Equity	39	11,725	87	18,753
(ii) Debt	–	–	1	118
B. Private Placement +				
1. Private Sector	**331**	**17,656**	**473**	**23,190**
a) Financial	147	9,590	181	13,978
b) Non-financial	184	8,066	292	9,212
2. Public Sector	**71**	**12,337**	**84**	**22,032**
a) Financial	38	5,802	63	13,489
b) Non-financial	33	6,535	21	8,543
3. Total (1+2)	**402**	**29,993**	**557**	**45,222**
Memo :				
Euro Issues	8	2,370	34	8,825

P : Provisional. * : Excluding offers for sale. – : Nil/Negligible. + : April-September.

year (constituting 22.8 per cent of resource mobilisation). All the IPOs in the current financial year so far have been by companies in the private sector. Equity issues continued to dominate the public issues market constituting 99.4 per cent of the total resource mobilisation during April-December 2005.

Mobilisation of resources through private placement witnessed a sharp turnaround – an increase of 50.8 per cent during April-September 2005 as against a decline of 9.7 per cent during April-September 2004 (Table 36). Resources mobilised by public sector entities (both financial and non-financial) increased by 78.6 per cent during April-September 2005 as against a decline of 47.2 per cent during April-September 2004. Public sector entities accounted for 48.7 per cent of total mobilisation through private placement during April-September 2005 as compared with 41.1 per cent during the same period of last year. Resources raised by financial intermediaries (both from public sector and private sector) accounted for 60.7 per cent of the total mobilisation by private placement during April-September 2005 (51.3 per cent during April-September 2004).

During April-December 2005, the resources raised through Euro issues – American Depository Receipts (ADRs), Global Depository Receipts (GDRs) and Foreign Currency Convertible Bonds (FCCBs) – by Indian corporates more than trebled to Rs.8,825 crore.

During April-December 2005, gross mobilisation of funds by mutual funds increased by 23.9 per cent to Rs.7,66,735 crore over the corresponding period of the previous year, while net funds (net of redemptions) increased substantially by 543.0 per cent during April-December 2005 over the corresponding period of the previous year (Table 37). Scheme-wise, a bulk (76.0 per cent) of the gross mobilisations of funds was under liquid/money market oriented schemes. 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 during April-December 2005, mainly due to attractive returns from these schemes in a buoyant secondary market.

Secondary Market

The stock markets remained buoyant during the third quarter of 2005-06 with BSE Sensex and S&P CNX Nifty touching all time highs reflecting strong macroeconomic fundamentals of the Indian economy, robust corporate earnings, congenial investment climate and sound business outlook. Strong liquidity support from both foreign institutional investors (FIIs) and mutual funds, firm trend in the major international equity markets and surge in ADR prices also helped to boost the market sentiment (Chart 51).

After touching a record high on October 4, 2005 on the BSE, the stock markets turned weak during the remainder of October 2005 on account of cautious approach adopted by investors ahead of the second quarter financial results of the companies and slowdown in investments by FIIs. However, the markets resumed buoyancy in the month of November 2005. The announcement of satisfactory financial results by corporates during the second quarter (Table 38),

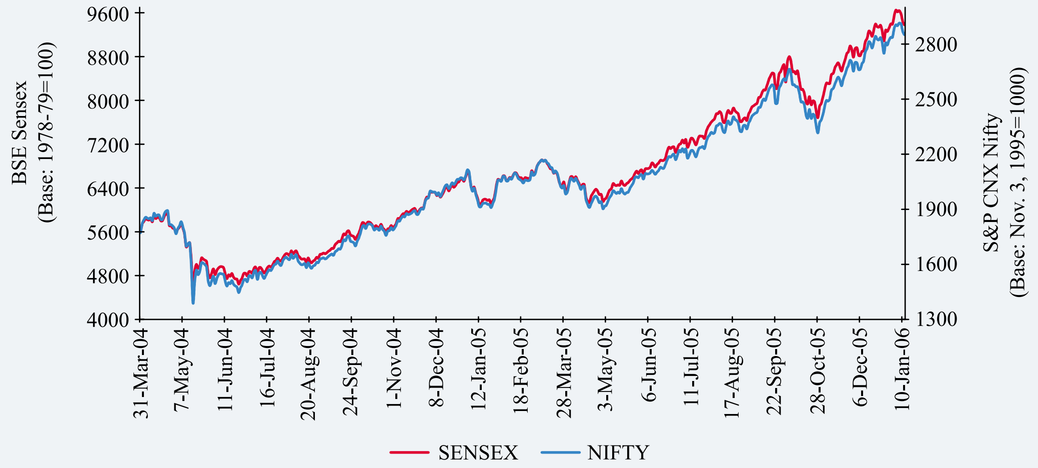
Table 37: Resource Mobilisation by Mutual Funds

(Rupees crore)

Mutual Fund	April-December 2004			April-December 2005		
	Gross Mobilisation	Net Mobilisation @	Net Assets *	Gross Mobilisation	Net Mobilisation @	Net Assets *
1	2	3	4	5	6	7
Private Sector	5,46,616	8,687	1,18,889	6,42,517	20,824	1,55,260
Public Sector	39,224	-1,439	10,671	70,094	5,683	18,760
UTI	32,915	-2,965	20,976	54,124	1,031	25,228
Total	**6,18,755**	**4,283**	**1,50,536**	**7,66,735**	**27,538**	**1,99,248**

@ : Net of redemptions. * : As at end of December.
Source : Securities and Exchange Board of India.

Chart 51: Indian Stock Markets



higher real GDP growth rate for the first half of 2005-06 and firm trends in major international equity markets also helped in improving the market sentiment and pushed the BSE Sensex above the 9000-mark. The BSE Sensex reached a new high of 9648 on January 4, 2006. However, the market sentiment turned subdued thereafter, mainly due to lower than expected third quarter financial results declared by some leading companies and slow down in FIIs investments in Indian equity markets. The BSE Sensex closed at 9238 on January 18, 2006.

Table 38: Corporate Financial Performance

(Growth rates in per cent)

	2003-04	2004-05	2004-05	2005-06	2004-05				2005-06	
			H1	H1	Q1	Q2	Q3	Q4	Q1	Q2
1	2	3	4	5	6	7	8	9	10	11
Sales	15.4	25.2	25.1	17.2	24.8	23.7	24.1	21.0	18.5	16.4
Expenditure	12.5	24.0	23.6	16.6	23.4	22.4	24.3	19.8	18.0	16.3
Gross Profits	26.6	38.9	39.4	26.7	36.0	35.8	30.5	35.3	32.0	19.1
Interest Cost	-11.5	-2.0	2.9	-10.3	-3.2	2.1	-13.0	-5.4	-13.5	-8.0
Profits After Tax	57.9	53.8	50.1	41.3	51.2	45.3	45.5	51.4	54.2	27.5
Memo:										
										(Amount in Rupees crore)
Number of Companies	2,201	1,273	1,171	2,168	1,255	1,353	1,464	1,301	2,355	2,361
Sales	4,28,072	5,68,476	2,53,747	3,67,769	1,35,156	1,53,040	1,62,193	1,79,632	1,94,608	2,12,693
Expenditure	4,06,838	4,90,204	2,16,622	3,15,139	1,15,656	1,31,227	1,40,574	1,56,647	1,66,972	1,83,717
Gross Profits	48,852	72,406	33,291	48,781	17,234	20,448	20,017	23,736	25,577	27,620
Interest Cost	14,724	12,528	6,418	8,083	3,597	3,584	3,273	3,177	4,241	4,467
Profits After Tax	26,281	47,333	20,634	32,016	10,396	13,004	13,196	16,798	16,726	18,169

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.

Table 39: Stock Market Indicators

Indicator	BSE				NSE			
	2003-04	2004-05	April-December		2003-04	2004-05	April-December	
			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	5489	7668	1428	1805	1728	2339
Volatility	22.95	11.15	9.32	12.17	23.3	11.28	9.70	11.26
P/E Ratio (End-period)*	18.57	15.61	17.07	18.61	20.70	14.60	15.32	17.16
Turnover (Rs. crore)	5,02,618	5,18,716	3,65,614	5,47,923	10,99,535	11,40,071	8,27,295	10,75,345
Market Capitalisation (Rs. crore) (End-period)	12,01,207	16,98,429	16,85,750	24,89,384	11,20,976	15,85,585	15,79,161	23,22,392

* : 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).

During the current financial year so far (up to January 18, 2006), the BSE Sensex has risen by 42.3 per cent over its end-March level, while the S&P CNX Nifty has increased by 38.0 per cent. The price-earnings (P/E) ratio of BSE Sensex stood at 17.9 as on January 18, 2006 as compared with 15.6 at end-March 2005 (Table 39).

The rally in the stock markets during the current fiscal has been wide-spread (Chart 52). On a point-to-point basis during current financial year so far (up to January 18, 2006), BSE 500 has increased by 38.3 per cent, while BSE

Chart 52: Trends in BSE Sectoral Stock Indices

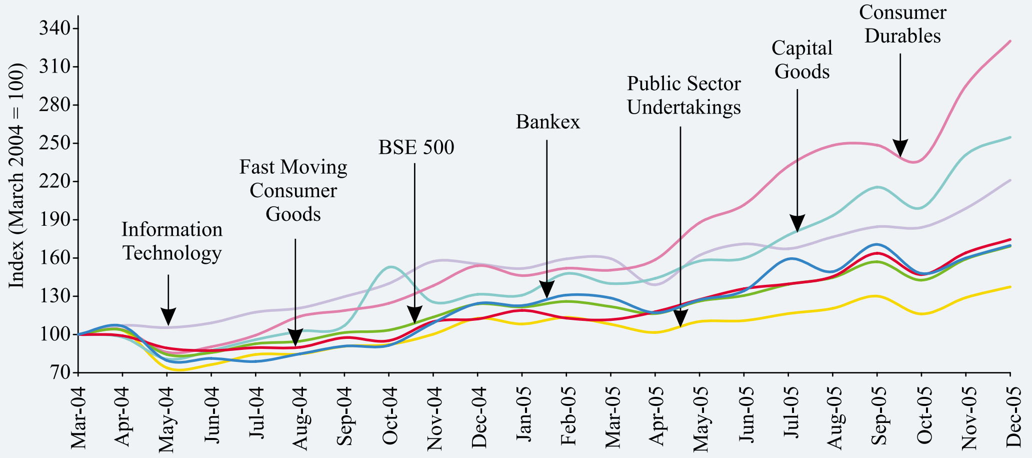
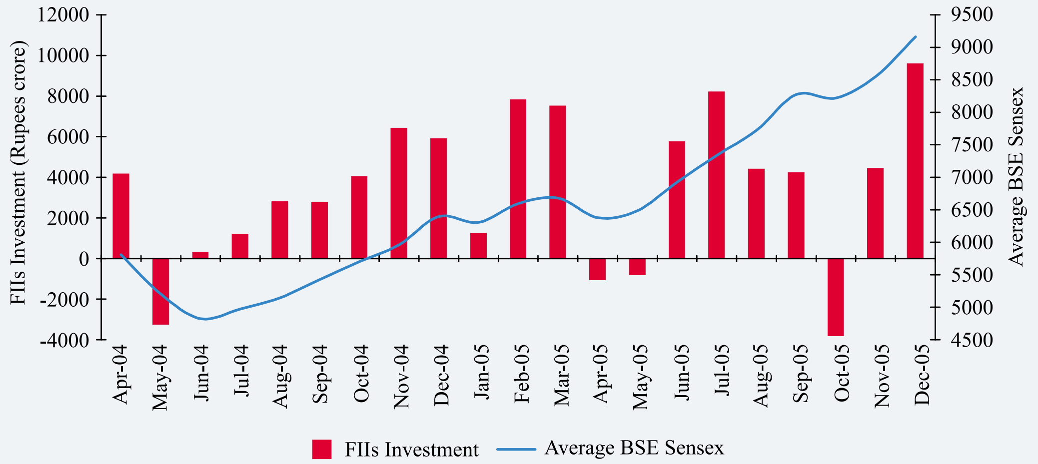


Chart 53: Trends in FIIs Investment and BSE Sensex

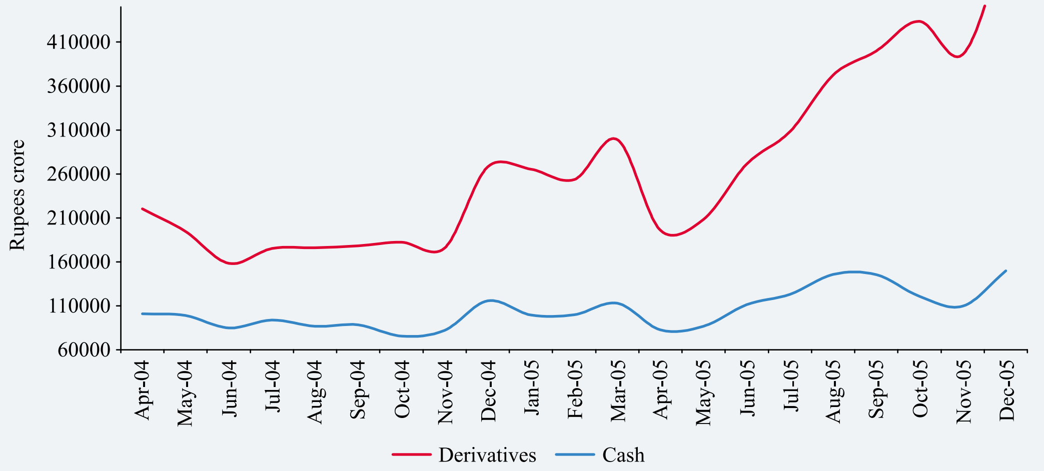


Small-cap and BSE Mid-cap has increased by 63.0 per cent and 48.0 per cent, respectively. Amongst the major sectors, BSE consumer durables index registered the highest gain (111.7 per cent) over end-March 2005, followed by capital goods (86.6 per cent), fast moving consumer goods (FMCG) (53.7 per cent), IT sector (31.4 per cent), banking index (30.3 per cent) and public sector undertakings (PSUs) (26.8 per cent). The consumer durables index rose sharply on account of robust corporate results led by increase in sales in electronics and auto segments and merger and acquisition activities in that sector. The FMCG sector performed well mainly due to normal progress of monsoon and its expected positive effect on sales of the FMCG products. The capital goods scrips were buoyant due to robust industrial activity, specifically in the manufacturing sector and continued encouraging investment climate. Satisfactory corporate results, increasing demand for Indian IT products from abroad and good performance of ADRs of IT sector companies led to a sharp increase in IT sector scrips.

As per the Securities and Exchange Board of India (SEBI), foreign institutional investors (FIIs) have made net investment of Rs.32,964 crore (US $ 7.4 billion) in the equity market during 2005-06 so far (up to January 17, 2006) on top of net purchases of Rs.24,619 crore (US $ 5.4 billion) during the corresponding period of the previous year (Chart 53). Mutual funds have also made net purchases in equities of Rs.10,195 crore during 2005-06 so far (up to January 17, 2006) as against net sales of Rs.1,255 crore during the corresponding period of the previous year.

At NSE, the total turnover in the cash segment increased by 30.0 per cent to Rs.10,75,345 crore during April-December 2005 from Rs.8,27,295 crore during the corresponding period of the previous year. The turnover in the NSE's derivative segment continued to be higher than in the cash segment. It increased by 79.8 per cent to Rs.31,09,089 crore during April-December 2005 (Chart 54).

Chart 54: Turnover in Derivative and Cash Segments - NSE



VI. THE EXTERNAL ECONOMY

Balance of payments (BoP) developments show that the current account deficit widened further during the second quarter (July-September) of 2005-06 over its level in the first quarter, led by a higher merchandise trade deficit. The balance of payments position, nonetheless, remained comfortable as capital flows continued to remain strong. Capital flows (net), in fact, doubled during the quarter, led by foreign portfolio investment flows and external commercial borrowings. With capital flows remaining in excess of the current account deficit, the overall balance of payments recorded a surplus. External debt increased marginally during the quarter ended September 2005. Foreign exchange reserves have declined by US $ 2.0 billion in the current fiscal year so far to US $ 139.5 billion as on January 13, 2006. The decline in the reserves was mainly on account of the redemption of the India Millennium Deposits (IMDs) on December 29, 2005. Various reserve adequacy indicators show that the current level of foreign exchange reserves is adequate.

International Developments

During the third quarter of calendar year 2005, global economic activity remained strong led by the US and Asian countries like China and India. Real GDP growth in advanced economies gathered some pace as strong activity in the US got support from Japan and the euro area (Table 40). After gaining momentum in the first quarter of 2005, domestic demand in the Japanese economy recovered further in the third 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. Despite weak domestic demand, European expansion has been facilitated by low long-term interest rates, euro depreciation and buoyant exports. Thus, notwithstanding record high international crude oil prices, global GDP growth exhibited a considerable degree of resilience during 2005. According to the International Monetary Fund (IMF), global economic activity is estimated to have grown 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.

Concomitantly, global current account imbalances have further accentuated with the US current account now projected by the Organisation for Economic Co-operation and Development (OECD) to increase from 5.7 per cent of GDP in 2004 to 6.5 per cent in 2005 and widen further to 6.7 per cent in 2006, reaching 7.0 per cent in 2007.

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.

Table 40: Growth Rates

(Per cent)

Country	2004	2004-Q2	2004-Q3	2004-Q4	2005-Q1	2005-Q2	2005-Q3
1	2	3	4	5	6	7	8
Advanced Economies							
Euro Area	2.1	2.2	1.8	1.5	1.4	1.1	1.6
Japan	1.7	2.8	2.4	0.4	1.4	2.6	2.9
OECD Countries	3.3	3.7	3.2	2.8	2.6	2.6	2.8
UK	3.1	3.7	2.1	2.9	2.1	1.5	1.7
US	4.4	4.6	3.8	3.8	3.6	3.6	3.6
Emerging Economies							
Argentina	9.0	7.1	8.7	9.1	8.0	10.1	9.2
Brazil	5.2	4.7	5.3	4.2	2.6	3.9	1.0
China	9.5	9.6	9.1	9.5	9.4	9.5	9.4
India	**6.9@**	**7.6**	**6.7**	**6.4**	**7.0**	**8.1**	**8.0**
Indonesia	5.1	4.3	5.0	6.7	6.4	5.5	5.3
Malaysia	7.1	8.0	6.8	5.6	5.7	4.1	5.3
South Korea	4.6	5.5	4.7	3.3	2.7	3.3	4.5
Thailand	6.9	6.4	6.1	5.1	3.3	4.4	5.3

@: FY 2004-05

Source : World Economic Outlook, September 2005, IMF; The Economist; and the OECD.

Global inflationary pressures, after remaining relatively contained during the first half of 2005, witnessed some pick up during the third quarter of 2005 moving in tandem with international crude oil prices. With crude oil prices retreating from their record highs of August 2005, headline inflation also edged down marginally during October-November 2005, *albeit* it still remains at elevated levels.

Growth in global trade during 2005 (January-September) showed signs of deceleration (Table 41). According to the IMF, the world trade volume is expected to increase by around 7.0 per cent in 2005 as compared with 10.3 per cent in 2004.

Table 41: Growth in Merchandise Exports: Global Scenario

(Per cent)

Region/ Country	2004	2004	2005
		(January-September)	
1	2	3	4
World	**21.2**	**21.5**	**13.8**
Industrial Countries	**17.4**	**18.5@**	**10.3@**
USA	13.0	13.7	10.9
Germany	21.3	21.6	10.1
Japan	19.9	22.0	6.2
United Kingdom	11.4	9.2*	11.7*
Developing Countries	**26.3**	**26.4@**	**19.1@**
China, P.R., Mainland	35.4	35.7@	32.2@
India	28.2	28.2^	18.7^
Korea	31.0	33.2#	12.4#
Singapore	24.6	25.5	14.2
Indonesia	12.6	9.2	22.2
Malaysia	20.5	22.2	10.8
Thailand	19.8	20.0	16.1

@: January-August. *: January-June 2005. ^ : January-December #: January-October.

Source : International Financial Statistics, International Monetary Fund, December 2005; and DGCI&S.

Merchandise Trade

India's merchandise exports recovered during December 2005 recording a growth of 16.2 per cent after having declined by 11.4 per cent during November 2005 (Chart 55). The sharp decline during November 2005 could be attributable to sectoral factors such as declines in the engineering goods, textiles and clothing, and gems and jewellery sectors. According to the Directorate General of Commercial Intelligence and Statistics (DGCI&S) data, exports (in US dollar terms) increased by 18.0 per cent during April-December 2005 on top of 26.7 per cent growth a year ago.

Disaggregated data available for April-October 2005 show that export growth has been broad-based. Exports of primary products were led by iron ore and minerals reflecting increased global demand for metals (Table 42). Exports of agricultural commodities were led by rice, coffee, raw cotton and cashew. In the manufacturing segment, engineering goods (transport equipment, machinery and parts, and manufactures of metals), gems and jewellery, and chemicals (dyes, intermediates and cosmetics and inorganic chemicals) continued to remain the key drivers of export growth. In the textiles segment, readymade garments remained as the mainstay, while textile yarns suffered a setback. Exports of petroleum products remained buoyant with a growth of 57.7 per cent during April-October 2005 on top of 89.4 per cent a year ago, benefiting from elevated international oil prices and reflecting the growing competitive strength of India's petroleum refinery sector.

Latin America continued to be the fastest growing region for India's exports during April-October 2005, followed by East Asia, Africa, South Asia,

Chart 55: India's Exports

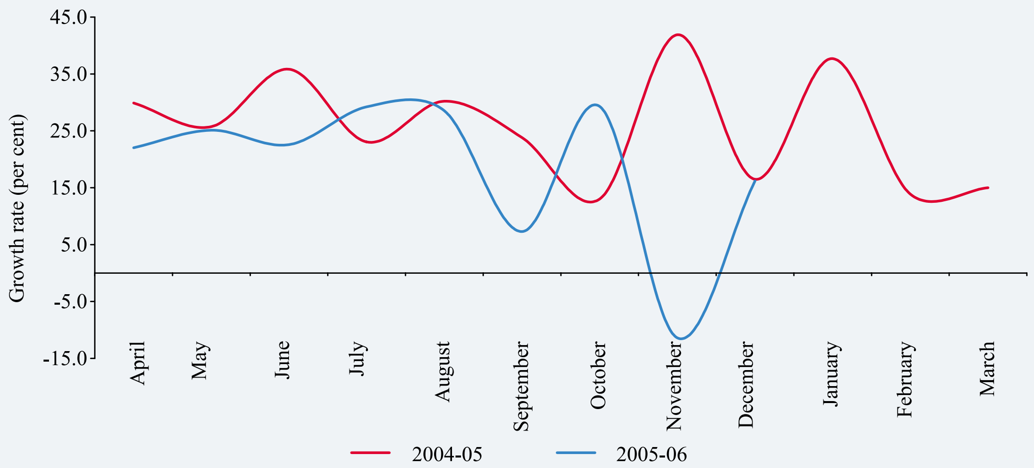


Table 42: Exports of Principal Commodities (April-October)

Item	2004-05	2005-06	2004-05	2005-06
	(US $ million)		(Growth rate in per cent)	
1	2	3	4	5
Agricultural and Allied Products	4,203	4,999	16.2	18.9
Ores and Minerals	1,998	2,727	89.0	36.5
Leather and Manufactures	1,320	1,404	15.5	6.3
Chemicals and Related Products	6,128	7,193	26.9	17.4
Engineering Goods	8,561	10,575	36.6	23.5
Textile and Textile Products	7,305	7,850	11.0	7.5
Gems and Jewellery	7,366	9,348	20.8	26.9
Petroleum Products	3,665	5,779	89.4	57.7
Total Exports	**42,334**	**52,284**	**28.3**	**23.5**

Source : DGCI&S.

and the European Union. The US, Singapore, China, Korea, Hong Kong, the Netherlands, France and the UK were the major markets for India's exports (Chart 56).

Import demand has continued to remain strong during 2005-06 so far although there was some deceleration during October-December 2005 to 15.7 per cent from 33.2 per cent a year ago due to a moderation in non-oil imports growth. Cumulatively, growth in non-oil imports during April-December 2005 was 20.1 per cent as compared with 33.0 per cent a year ago (Chart 57). Non-oil imports excluding gold and silver witnessed a rise of 30.8 per cent during April-October 2005, led by imports of industrial inputs. Within industrial inputs, capital goods posted a growth of 32.2 per cent during April-October 2005 (28.6 per cent a year ago) reflecting investment demand in the economy.

Chart 56: Destination of India's Exports

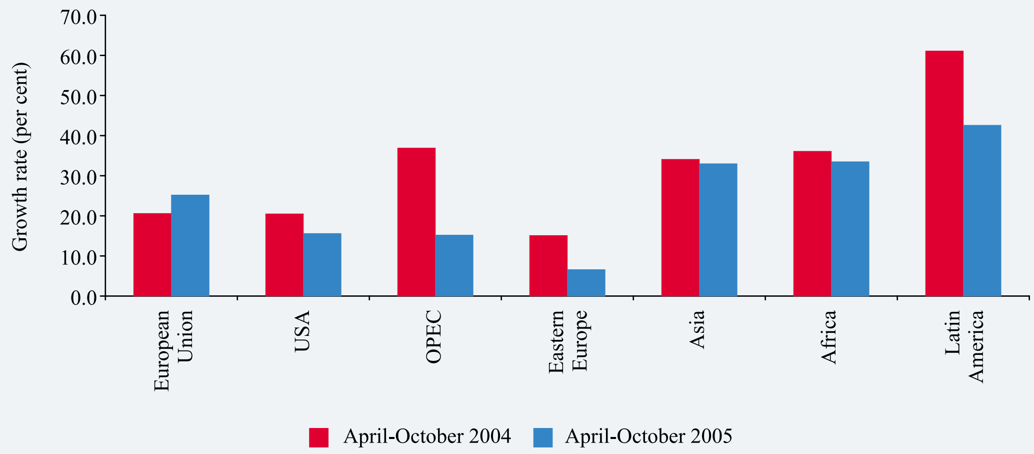
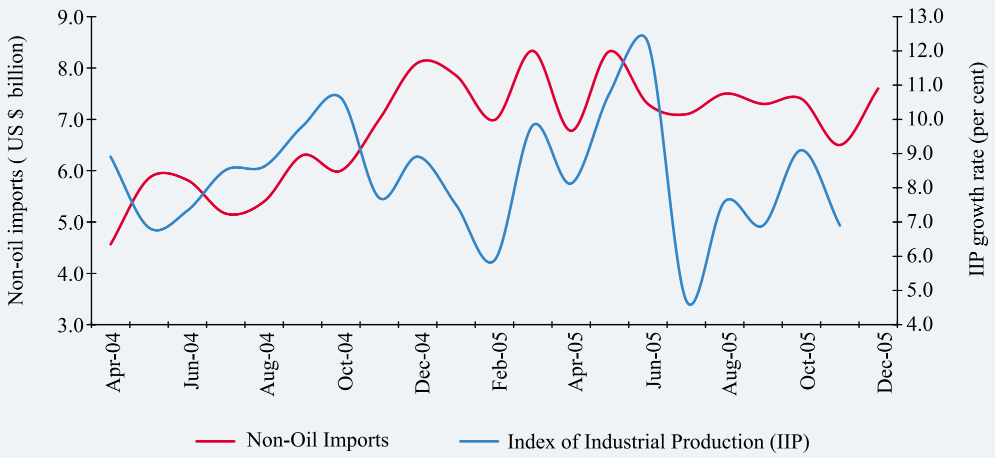


Chart 57: Imports and Industrial Production



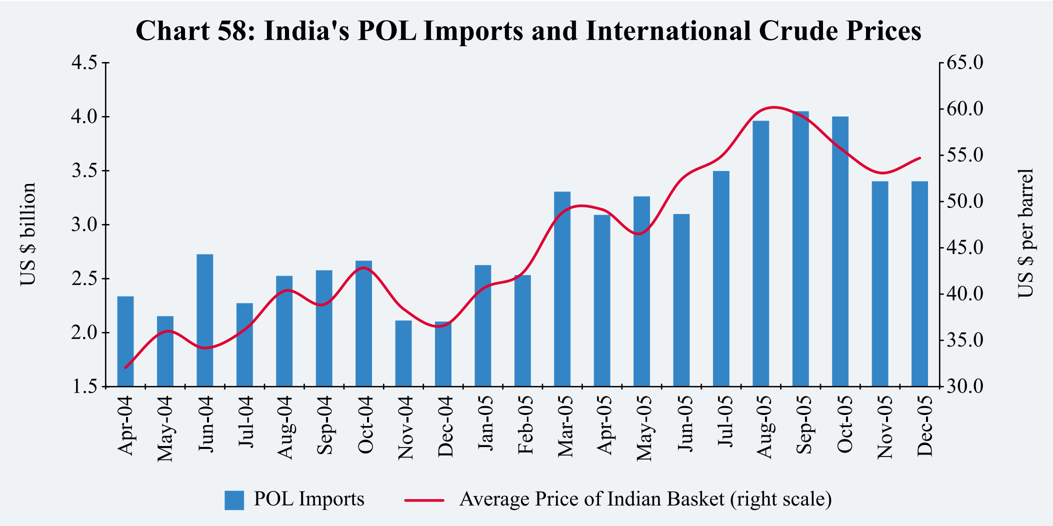
Among other items, imports of iron and steel increased sharply by 95.0 per cent during April-October 2005 on top of 66.2 per cent a year ago, reflecting the sustained expansion in domestic demand (Table 43). Imports of mainly export related items recorded a higher growth than a year ago due to pearls, precious stones and chemicals. Among bulk goods, edible oil imports recorded a decline while fertiliser and non-ferrous metals registered a steep rise during April-October 2005.

The rise in petroleum, oil and lubricants (POL) imports (45.4 per cent) in April-December 2005 was due to a sharp increase in international crude oil prices. The average crude oil price (Indian basket) at US $ 54 per barrel during April-December 2005 recorded a rise of 44.8 per cent over the previous year (Chart 58). In volume terms, oil imports are estimated to have declined

Table 43: Imports of Principal Commodities (April-October)

Item	2004-05	2005-06	2004-05	2005-06
	(US $ million)		(Growth rate in per cent)	
1	2	3	4	5
Petroleum and Products	17,249	24,392	56.8	41.4
Edible oil	1,463	1,240	-11.9	-15.3
Metalliferrous Ores and Metal Scrap	1,245	1,955	70.2	57.0
Iron and Steel	1,323	2,580	66.2	95.0
Capital Goods	11,395	15,061	28.6	32.2
Pearls, Precious and Semi Precious Stones	4,530	6,178	25.9	36.4
Organic and Inorganic Chemicals	2,871	3,461	32.9	20.6
Gold and Silver	5,159	6,917	28.8	34.1
Total Imports	**57,060**	**76,648**	**36.9**	**34.3**
Memo:				
Non-oil Imports excluding Gold and Silver	34,651	45,339	29.9	30.8
Mainly Industrial Inputs	31,641	41,821	33.4	32.2

Source : DGCI&S.



by 0.7 per cent during April-October 2005 (as against an increase of 10.5 per cent a year ago).

During April-October 2005, China emerged as the largest source of India's imports, followed by the US, Switzerland, Germany, Belgium, UAE and Australia. Imports from China amounted to US $ 5.2 billion during April-October 2005 (6.8 per cent of India's total imports) while imports from the US were placed at US $ 4.1 billion (5.3 per cent of India's total imports).

Trade deficit, based on DGCI&S data, increased by 54.2 per cent to US $ 29.8 billion during April-December 2005 (Table 44). During April-October 2005, the non-oil trade balance showed a deficit of US $ 5.8 billion as compared with a deficit of US $ 1.1 billion a year ago.

Table 44: India's Merchandise Trade

(US $ billion)

Item	2004-05	2004-05 (April-December)	2005-06 (April-December)
1	2	3	4
Exports	80.5 (26.2)	56.3 (26.7)	66.4 (18.0)
Imports	109.2 (39.7)	75.6 (36.3)	96.3 (27.3)
Oil	29.8 (45.1)	21.4 (45.5)	31.1 (45.4)
Non-Oil	79.3 (37.8)	54.2 (33.0)	65.1 (20.1)
Trade Balance	- 28.6	-19.3	-29.8

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 July-September 2005, *albeit* lower than the previous quarter (Table 45). Gross invisible receipts during July-September 2005 recorded a strong rise of 62.5 per cent over the position a year ago due to a sustained growth in travel earnings and continuing pace of export of software and other business and professional services and stable remittances from overseas Indians. Private transfers contributed about 24 per cent of gross invisible receipts. Gross invisibles payments during July-September 2005 registered a sharp rise of 79.1 per cent on account of outbound tourist traffic, transportation and insurance payments, and rising import demand for business services such as business and management consultancy, engineering, technical and distribution services. On the whole, the net invisible surplus during July-September 2005 at US $ 8.5 billion was US $ 2.4 billion higher than the surplus a year ago. Consequently, the cumulative surplus during the first half of 2005-06 at US $ 18.7 billion was US $ 4.4 billion (31 per cent) higher than in the corresponding period of the previous year.

While the net invisible surplus expanded by US $ 4.4 billion during April-September 2005, the merchandise trade deficit, on payments basis, expanded by US $ 16.9 billion to US $ 31.6 billion during April-September 2005. Net invisible surplus during April-September 2005 thus could finance only 59 per cent of the trade deficit and the current account balance recorded a deficit of US $ 13.0 billion - as compared with a modest deficit of US $ 0.5 billion a year ago (Table 46).

Table 45: Invisibles Account (Net)

(US $ million)

Item	2004-05 (April-March)	2004-05			2005-06		
		April-June	July-Sept.	April-Sept.	April-June	July-Sept.	April-Sept.
1	2	3	4	5	6	7	8
Travel	985	-62	24	-38	-454	-619	-1,073
Transportation	259	272	-21	251	-675	-765	-1,440
Insurance	187	-32	50	18	-25	352	327
Government not included elsewhere	67	61	5	66	-33	-87	-120
Software	16,526	3,710	3,859	7,569	4,853	4,989	9,842
Other Services	-3,825	-927	-959	-1,886	1,056	920	1,976
Transfers	20,844	5,890	4,330	10,220	6,479	5,766	12,245
Income	-3,814	-758	-1,159	-1,917	-1,070	-2,008	-3,078
Investment Income	-2,669	-527	-903	-1,430	-741	-1,676	-2,417
Compensation of Employees	-1,145	-231	-256	-487	-329	-332	-661
Total	**31,229**	**8,154**	**6,129**	**14,283**	**10,131**	**8,548**	**18,679**

Table 46: India's Balance of Payments

(US $ million)

Item	2004-05 (April-March)	2004-05			2005-06		
		April-June	July-Sept.	April-Sept.	April-June	July-Sept.	April-Sept.
1	2	3	4	5	6	7	8
Exports	82,150	17,840	18,875	36,715	21,991	22,770	44,761
Imports	1,18,779	22,980	28,503	51,483	37,418	38,978	76,396
Trade Balance	-36,629	-5,140	-9,628	-14,768	-15,427	-16,208	-31,635
Invisibles, net	31,229	8,154	6,129	14,283	10,131	8,548	18,679
Gross Receipts	71,854	16,708	14,635	31,343	24,053	23,778	47,831
Gross Payments	40,625	8,554	8,506	17,060	13,922	15,230	29,152
Current Account	-5,400	3,014	-3,499	-485	-5,296	-7,660	-12,956
Capital Account*	31,559	4,556	2,865	7,421	6,542	12,916	19,458
Change in Reserves # (-Indicates increase)	-26,159	-7,570	634	-6,936	-1,246	-5,256	-6,502

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

Capital Flows

Capital flows to India have remained strong during 2005-06 so far, led by foreign investment flows and external commercial borrowings. Capital flows (net) more than doubled to US $ 19.5 billion during April-September 2005 from US $ 7.4 billion a year ago (Table 46). Foreign direct investment inflows into India during April-October 2005 were 35 per cent higher than in the corresponding period of 2004 (Table 47). Net FDI into India picked up on sustained growth in activity and positive investment climate with inflows going into manufacturing, business and computer services. Outward FDI remained on track reflecting the appetite of Indian companies for global expansion in terms of markets and resources.

After remaining subdued during April-May 2005, Foreign Institutional Investors (FIIs) made large purchases in the Indian stock markets in the subsequent period. The net cumulative FII inflows during April-December 2005 amounted to US $ 5.1 billion (US $ 4.7 billion during the corresponding period of the previous year). The number of FIIs registered with the SEBI increased from 685 at end-March 2005 to 823 by end-December 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) remained buoyant as booming stocks offered corporates the opportunity to issue equities abroad.

Table 47: Capital Flows

(US $ million)

Component	Period	2004-05	2005-06
1	2	3	4
Foreign Direct Investment	April-October	2,682	3,631
FIIs (Net)	April-December	4,700	5,098
ADRs/GDRs	April-October	170	1,427
External Assistance (Net)	April-September	346	436
External Commercial Borrowings (Medium and long-term) (Net)	April-September	1,526	2,752
Short-term Trade Credits (Net)	April-September	1,963	938
NRI Deposits (Net)	April-October	-688	231

Notwithstanding further firming up of international interest rates, demand for external commercial borrowings (ECBs) increased during July-September 2005 in consonance with the sustained pick-up in economic activity. Net disbursements under short-term trade credit turned positive during July-September 2005 after having recorded net outflows during the first quarter. Non-Resident Indian deposit accounts recorded modest inflows during April-October 2005 as against outflows during April-October 2004 (Table 47).

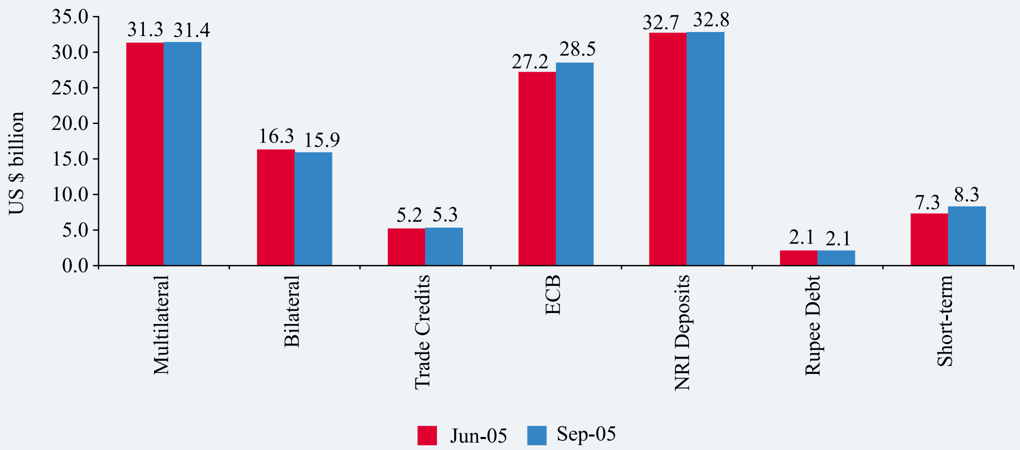
Foreign Exchange Reserves

During the first half 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 $ 6.5 billion on a balance of payments basis (*i.e.*, excluding valuation effects).

India's foreign exchange reserves stood at US $ 139.5 billion as on January 13, 2006, registering a decline of US $ 2.0 billion over end-March 2005 level. The decline in reserves was mainly on account of the redemption of India Millennium Deposits (IMDs). The Reserve Bank sold foreign exchange aggregating US $ 7.1 billion during December 27-29, 2005 to the State Bank of India (SBI) to meet the IMD redemption. SBI had raised equivalent of US $ 5.5 billion in the year 2000 under the IMD scheme from non-resident deposits and the maturity amount (principal and interest payment) aggregated US $ 7.1 billion.

India holds 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.

Chart 59: India's External Debt



External Debt

India's total external debt registered an increase of US $ 2.2 billion (1.8 per cent) during the quarter ended September 2005 and stood at US $ 124.3 billion at end-September 2005. The increase during the quarter primarily reflected higher recourse to commercial borrowing and export credit. Short-term debt also increased on account of increase in trade credit to finance higher imports (Chart 59).

Key external debt indicators reflect the growing sustainability of external debt of India (Table 48). Although the ratios of short-term to total debt and short-term debt to foreign exchange reserves increased marginally during the quarter ended September 2005, they remain quite modest. India's foreign exchange reserves exceeded the external debt by US $ 18.7 billion providing a cover of 115.1 per cent to the external debt stock at the end of September 2005. The share of concessional debt in total external debt continued its declining trend reflecting a gradual increase in non-concessional private debt. Nonetheless, the concessional debt continues to be a significant proportion of the total external debt, especially by international standards.

Table 48: Indicators of Debt Sustainability

(Per cent)

Indicator	March 2004	March 2005	September 2005
1	2	3	4
Concessional debt/Total debt	36.1	33.3	31.6
Short-term/Total debt	4.0	6.1	6.7
Short-term debt/Reserves	3.9	5.3	5.8
Reserves/ Total debt	101.1	114.8	115.1