

V. FINANCIAL MARKETS

International financial market conditions during 2005-06 continued to remain favourable, notwithstanding a sharp rise in international crude oil prices and growing global financial imbalances. Although short-term interest rates moved up in a number of economies following tightening of monetary policy to anchor inflationary expectations in view of pressures emanating from higher energy prices, long-term nominal rates remained largely benign with real long-term interest rates ruling at very low levels. Equity markets remained buoyant, especially in emerging market economies (EMEs), on steady improvement in the fundamentals, improved growth prospects and increased appetite for risk. Emerging market spreads continued to hover around record low levels, reflecting shortage of foreign currency denominated bonds on account of improvements in the fiscal position of many EMEs as well as buybacks of outstanding bonds.

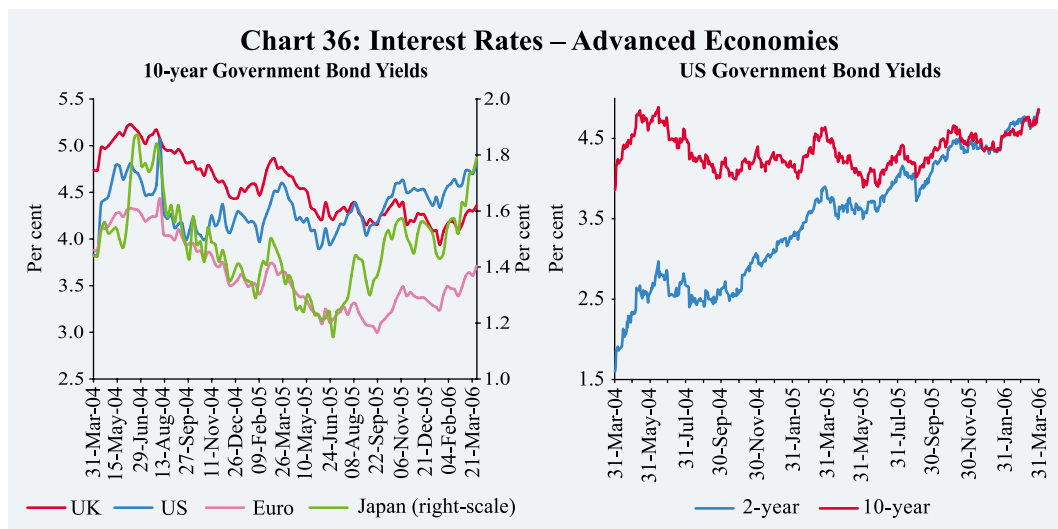
Short-term rates increased in a number of economies during 2005-06 as central banks raised their policy rates to ward off inflationary pressures from higher international crude oil prices in an environment of strong demand (Table 36). Amongst the advanced economies, the US recorded the maximum increase in rates, reflecting hikes by the Federal Open Market Committee (FOMC) in the federal funds rate target in each of its meetings held since June 2004. In some

Table 36: Short-term Interest Rates

(Per cent)						
Region/Country	March 2004	March 2005	June 2005	September 2005	December 2005	March 2006
1	2	3	4	5	6	7
Advanced Economies						
Euro Area	1.96	2.15	2.10	2.15	2.48	2.80
Japan	0.03	0.02	0.02	0.02	0.02	0.04
Sweden	2.12	1.97	1.48	1.46	1.68	1.99
UK	4.31	4.95	4.75	4.56	4.59	4.58
US	1.04	2.90	3.33	3.85	4.23	4.77
Emerging Market Economies						
Argentina	2.88	4.56	6.94	6.69	8.00	9.63
Brazil	16.02	19.25	19.74	19.51	18.03	16.54
China	n.a.	2.25	2.30	4.38	2.90	2.40
Hong Kong	0.17	2.79	3.36	4.12	4.18	4.47
India	4.24	5.37	5.37	5.49	6.02	6.11
Malaysia	3.00	2.82	2.87	2.92	3.20	3.51
The Philippines	9.19	7.25	5.88	8.13	7.69	7.38
Singapore	0.69	2.06	2.06	2.34	3.22	3.44
South Korea	3.90	3.54	3.52	3.94	4.07	4.26
Thailand	1.31	2.64	2.75	3.90	4.50	5.10
n.a. : Not available.						
Note : Data for India refer to 91-day Treasury Bills rate and for other countries 3-month money market rates.						
Source : The Economist.						

economies such as the UK short-term rates eased in response to weakening of economic activity.

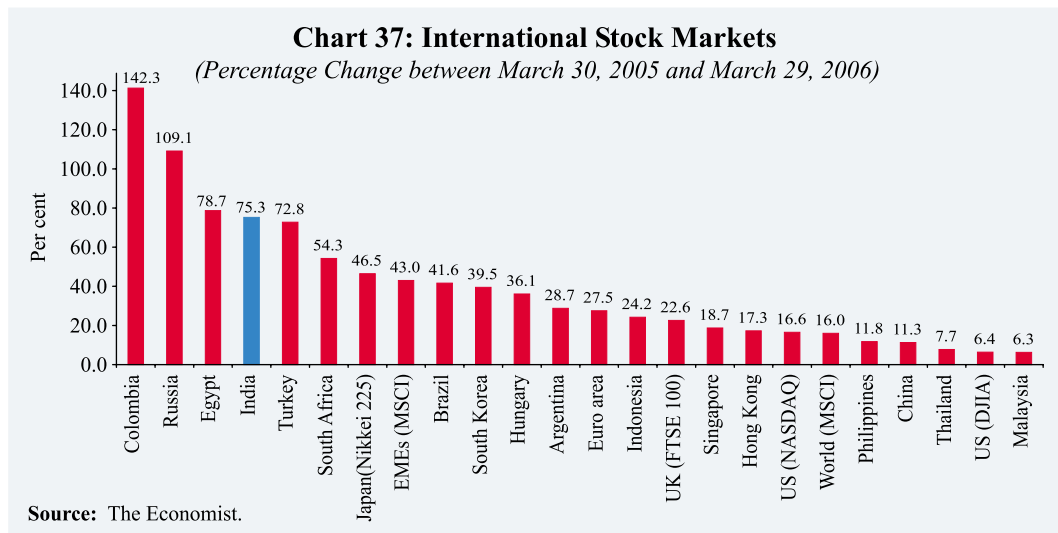
In contrast to the uptrend in short-term rates, long-term Government bond yields in the US as well as in the Euro area remained largely range-bound during 2005-06. Structural factors such as increased demand for fixed income products from pension funds and insurance companies in response to regulatory changes provided support to long-term gilts. Excess of global savings over global investment and reduction in inflation risk premium also contributed to the flattening of the long-term yields during 2005-06. Yields in the US declined initially during April-June 2005 on expectations that monetary authorities could slow down policy tightening due to fragility in the economic recovery. The US 10-year Treasury yield was at a 14-month low at 3.8 per cent in early-June 2005. Yields, however, firmed up during July 2005 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 in the third quarter of 2005-06 in the US and in the Euro area in tandem with sharp rise in headline inflation and higher short-term rates which increased expectations regarding future policy rates. In the second half of December 2005, 10-year yields eased again and by the close of December, the yield curve in the US became inverted (Chart 36). Yields again increased from the second week of January 2006. The 10-year yield rose to 4.86 per cent on March 31, 2006, the highest since June 2004 on the back of strong data and expectations that the US FOMC may push the federal funds rate target higher than expected. In the Euro area, the increase in long-term yields was also on account of improved economic outlook. In Japan, long-term yields increased, reflecting recovery in domestic demand and better economic prospects. The

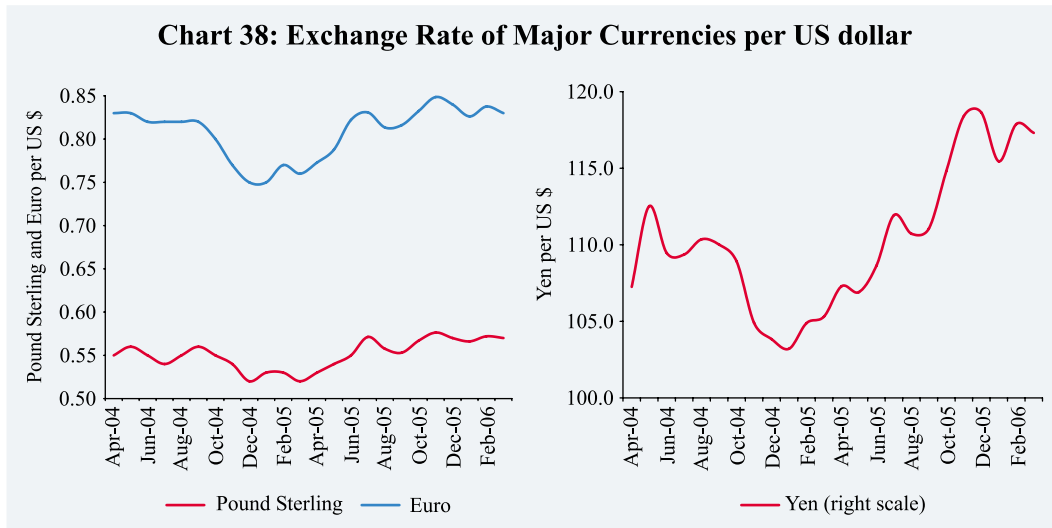


decision of the Bank of Japan in March 2006 to change the operating target of money market operations from the outstanding balance of current accounts at the Bank to the uncollateralised overnight call rate also pushed up yields in Japan. In the UK, the yields eased marginally during 2005-06 in tandem with short-term rates.

Equity markets in many economies, especially EMEs, exhibited buoyancy during 2005-06. Improvements in the fundamentals of EMEs as well as higher risk appetite in an environment of very low long-term real interest rates also increased foreign investors' enthusiasm for emerging market equities, pushing up valuations sharply and in some cases to new highs. Intra-year movements in equity prices were influenced by concerns over oil prices led by inflationary pressures and the likely future course of monetary policy. In the wake of sharp increase in inflation during September 2005 and the prospects of a 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 and some moderation in international crude oil prices. During 2005-06, the Indian equity markets outperformed major international equity markets except Colombia, Russia and Egypt (Chart 37). 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 the US investors in overseas markets. Equity markets in Asia witnessed some decline in the second week of April 2006 on concerns that higher commodity prices could lead to further monetary tightening.

Notwithstanding concerns over the widening current account deficit in the US, the US dollar appreciated during 2005-06 benefiting from the growing interest and growth differential in favour of the US and a year-long tax break designed to encourage US multinationals to repatriate cash held overseas (Chart 38).





Indian financial markets remained orderly during 2005-06 even as interest rates edged up across the spectrum. Liquidity conditions turned tight from mid-December 2005 due to the redemption of the India Millennium Deposits (IMDs) in the wake of sustained credit growth and some build-up of cash balances by the Government of India. Reflecting the liquidity conditions, call money rates which had remained generally close to the reverse repo rate during the most part of the first half of 2005-06 crossed the repo rate during the fourth quarter. Interest rates in the collateralised segment of money markets also edged up during the year, although they remained below the repo rate during the fourth quarter. The foreign exchange market remained more or less orderly, exhibiting two-way movements. Yields in the Government securities market hardened during 2005-06, with the increase at the longer end less than at the short-end. In the credit market, deposit and lending rates edged up during the year as credit demand accelerated further. Capital markets remained buoyant during 2005-06. Resources raised by the Indian corporates through domestic as well as Euro issues increased substantially. The stock indices reached record highs, driven by increased interest by domestic as well as foreign investors on the back of strong macroeconomic fundamentals (Table 37).

Money Market

Money market conditions, which remained comfortable up to October 2005, turned somewhat tight thereafter. During April 2005, the Reserve Bank supplemented reverse repo operations with the sale of Government paper under the Market Stabilisation Scheme (MSS) to absorb liquidity and balance market conditions. Average daily call money borrowing rates ruled at sub-reverse repo

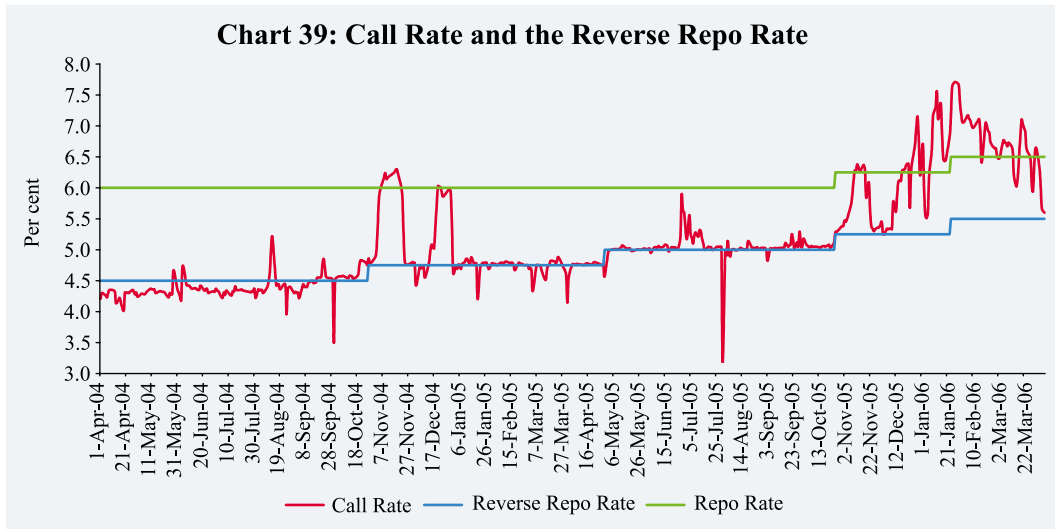
Macroeconomic and Monetary Developments in 2005-06

Table 37: Domestic Financial Markets at a Glance

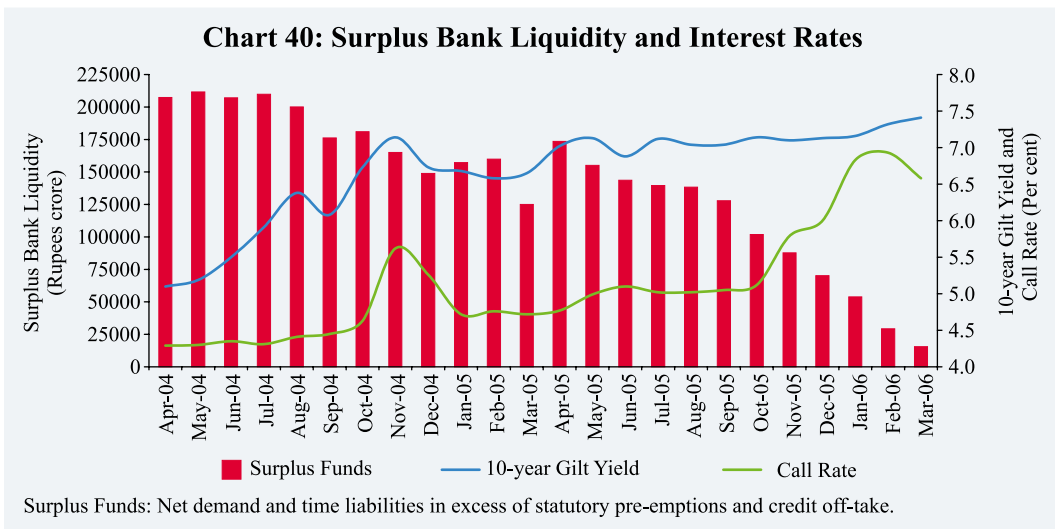
Month	Call Money		Government Securities		Foreign Exchange				Liquidity Management			Equity		
	Average Daily Turnover (Rs. crore)	Average Call Rates* (Per cent)	Average 10-Year Yield@ (Per cent)	Average Turnover in Govt. Securities (Rs. crore)+	Average Daily Inter-bank Turnover (US \$ million)	Average Exchange Rate (Rs. per US \$)	RBI's net Foreign Currency Sales(-)/ Purchases (+) (US \$ million)	Average Forward Premia (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	46.10	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	6.72	4,305	9,447	43.98	1,393	2.02	52,058	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	7.13	3,698	11,003	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	11,749	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	11,040	43.92	0	0.62	67,617	31,570	3,871	6,923	8272	2512
October	17,164	5.12	7.13	2,815	13,087	44.82	0	0.69	68,602	18,608	2,955	6,040	8220	2487
November	22,620	5.79	7.10	3,314	11,228	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	-6,541	1.51	52,040	1,452	3,516	6,814	9162	2773
January	17,911	6.83	7.16	3,094	16,365 P	44.40	0	2.60	40,219	-15,386	3,966	7,472	9540	2893
February	13,497	6.93	7.32	2,584	15,644 P	44.33	2,614	2.85	33,405	-13,532	3,687	7,125	10090	3019
March	18,290	6.58	7.41	2,203	n.a.	44.48	n.a.	3.11	29,652	-6,017	5,398	9,518	10857	3236

* : Average of daily weighted call money borrowing rates. + : Average daily outright turnover in Central Government dated securities.
 @ : Average of daily closing rates. ** : Average of daily closing indices. LAF : Liquidity Adjustment Facility.
 MSS : Market Stabilisation Scheme. BSE : The Stock Exchange, Mumbai. NSE : National Stock Exchange of India Ltd.
 # : Average of weekly outstanding MSS. P : Provisional n.a. : Not available.
 Note : In column 11, (+) indicates absorption and (-) indicates injection of liquidity.

rate levels on many occasions. With the increase in the fixed reverse repo rate by 25 basis points on April 29, 2005, call rates also edged up by a similar magnitude. Towards the end of June 2005, call rates rose above the reverse repo rate under liquidity pressures on account of 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 return of advance tax payments to the banking system. Large foreign currency purchases from the authorised dealers during July-August 2005 also improved liquidity conditions. 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

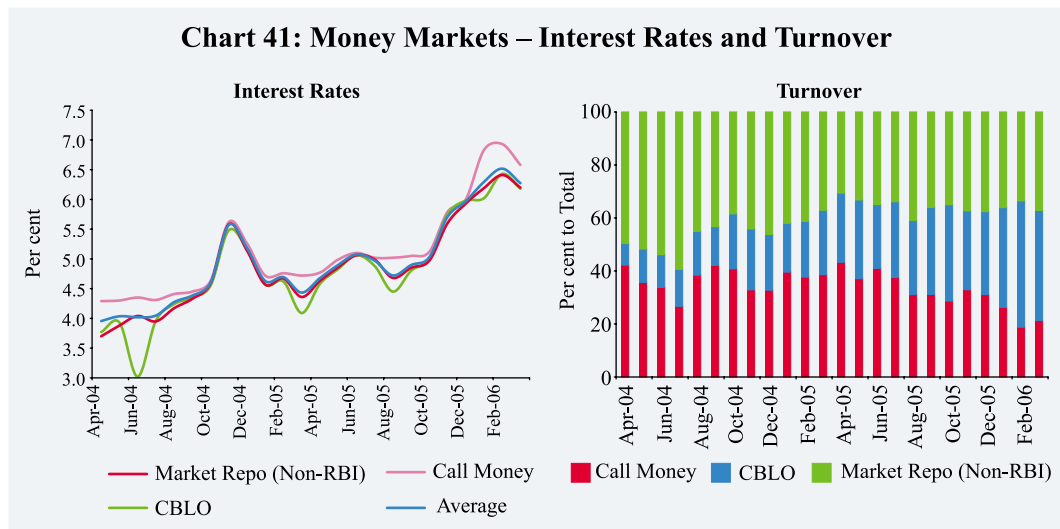


of September 2005. During the second half of September 2005, the call money market witnessed mild pressure, on account of advance tax outflows and scheduled auctions. For the most part of October 2005, the call money rate hovered around the reverse repo rate as liquidity conditions remained comfortable (Charts 39 and 40). 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 liquidity pressures emanating from sustained credit demand, festival demand for currency and scheduled auctions. The Reserve Bank, therefore, injected liquidity into the system through LAF repos on seven occasions during the month. The notified amount of Treasury Bills auctions under the MSS was also cancelled.



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 with the second half of December 2005, call money rates again edged up as the market witnessed frictional liquidity pressures emanating from sustained large credit offtake and quarter-end advance tax payments amidst uncertainty relating to the redemption of IMDs. The call money rates hovered above the repo rate for the most part of the fourth quarter of 2005-06. In contrast, the interest rates in the collateralised segments of the money market – which account for a growing and predominant share (about 70 percent) of the total money market turnover – remained below the repo rate (Chart 41). For instance, the rates in the Collateralised Borrowing and Lending Obligation (CBLO) segment averaged 6.23 per cent during January-February 2006, lower than that of 6.88 per cent in the call money market. The higher call money rates during the last quarter of 2005-06 reflected not only liquidity pressures but also the divergent nature of the overnight markets between the collateralised and uncollateralised segments. The call rates eased from the second half of March 2006, reflecting improvement in liquidity conditions. The call money rate was 5.55 per cent as on April 12, 2006. The turnover in the call/notice money market during 2005-06 remained range-bound, in contrast to the uptrend in the collateralised segments. This reflected the relatively higher rates in the call money market as well as the process of phasing out of non-bank participants from the call money market, which was completed on August 6, 2005 (Table 38). The supply of funds in the CBLO segment has been augmented by the participation of banks, mutual funds and financial institutions. Members operating in the CBLO segment of the Clearing Corporation of India Limited (CCIL) increased from 110 as on March 31, 2005 to 152 as on March 31, 2006.



Financial Markets

Table 38: Activity in Money Market Segments

(Rupees crore)							
Month	Average Daily Turnover				Outstanding Amount		Forward Rate Agreements/ Interest Rate Swaps (Notional Amount)
	Call Money Market	Term Money Market	Repo Market (Outside the LAF)	Collateralised Borrowing and Lending Obligation (CBLO)	Commercial Paper	Certificates of Deposit	
1	2	3	4	5	6	7	8
2004-05							
April	12,916	325	15,195	2,496	10,362	4,725	5,76,808
May	10,988	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	9,625	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	18,726	29,193	13,42,335
November	22,620	917	25,660	20,496	18,013	27,457	14,75,384
December	21,149	775	25,574	21,265	17,234	32,806	13,92,606
January	17,911	1,089	24,596	25,634	16,431	34,521	13,16,351
February	13,497	813	24,096	34,162	15,876	33,986	13,37,720
March	18,290	1,338	31,964	35,775	12,693 *	36,931 #	n.a.

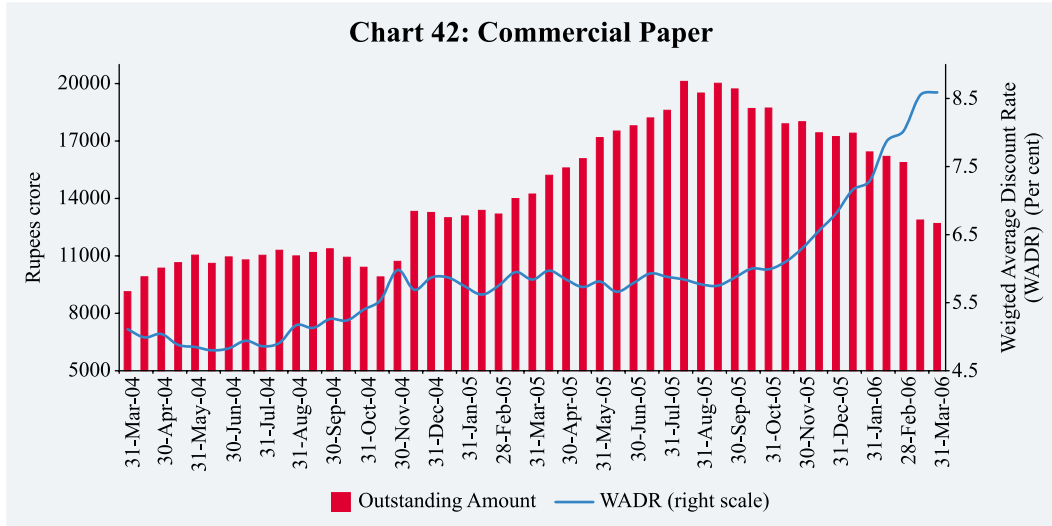
n.a. : Not available.

* : Provisional.

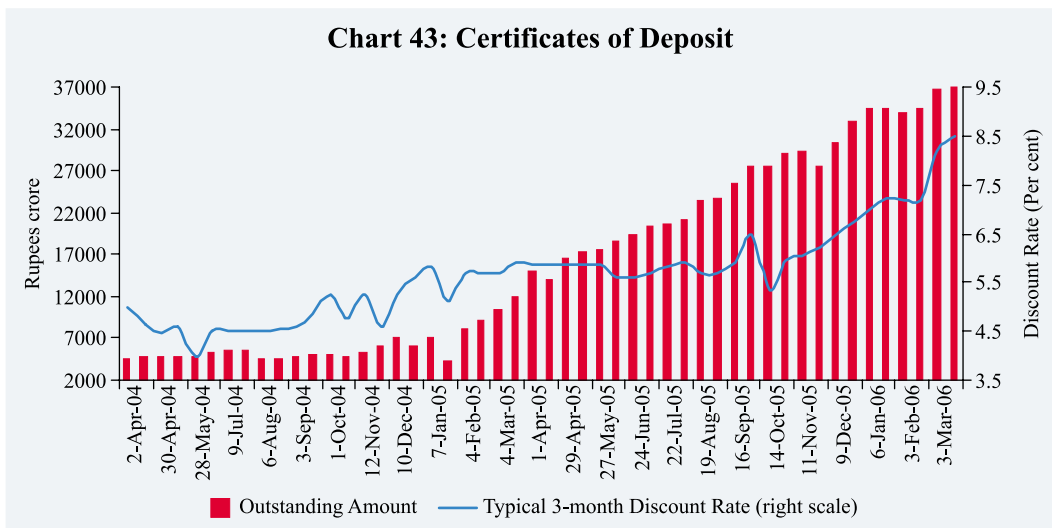
: As on March 17, 2006.

Other Money Market Instruments

Issuances of commercial paper (CP), which had exhibited sustained increases till mid-September 2005, witnessed a slowdown during the second half of 2005-06, reflecting tight liquidity conditions. Outstanding CPs after increasing from Rs.14,235 crore at end-March 2005 to Rs.20,019 crore by mid-September 2005 declined to Rs.12,693 crore by end-March 2006 (Chart 42). The weighted average discount rate (WADR) on CPs increased from 5.84 per cent on March 31, 2005 to 8.59 per cent on March 31, 2006. Leasing and finance companies with their share at 74.1 per cent (as on March 31, 2006) continued to be the largest issuers of CPs, partly reflecting the policy of phasing out the access to these companies to public deposits. Manufacturing and other companies and financial institutions are the other major issuers with shares of 15.4 per cent and 10.5 per cent, respectively, as on March 31, 2006.



Issuances of certificates of deposit (CDs) increased sharply during 2005-06, reflecting banks' demand for funds in the wake of acceleration in demand for bank credit (Chart 43). The amount of CDs outstanding nearly trebled during 2005-06 from Rs.12,078 crore at end-March 2005 to Rs.36,931 crore by March 17, 2006 (constituting 4.3 per cent of aggregate deposits of issuing banks, broadly the same as a year ago). The increase in the outstanding amount was mainly on account of higher issuances by some private sector banks, reflecting the cost attractiveness of the CDs to the banks *vis-à-vis* time deposits. The higher recourse to CDs was also driven by reduction in the minimum maturity period to seven days. The typical three-month discount rate on CDs at 8.50 per cent on March



17, 2006 was higher by 263 basis points over its level at end-March 2005. As in the case of CPs, mutual funds have emerged as key investors in CDs.

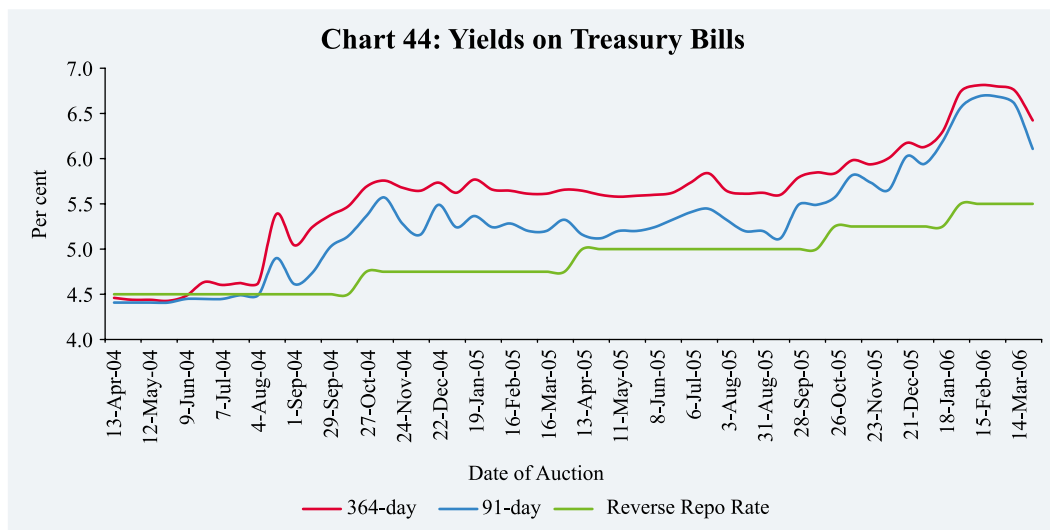
Treasury Bills

Yields in Treasury Bills (TB) auctions increased during 2005-06, reflecting tight liquidity conditions. After remaining generally range-bound during the first half of 2005-06, the yields edged higher in the subsequent months. In view of the prevalent liquidity conditions, the Reserve Bank rejected all the bids for the Treasury Bills auctions under the MSS scheduled on November 9, 2005 and discontinued the auctions under the MSS from November 16, 2005. The yields after having recorded a sharp increase during January-February 2006, however, eased during March 2006 reflecting improvement in liquidity conditions. Yields in March 2006 were 103-127 basis points higher over their March 2005 levels. The yield spread between the 91-day and 364-day TBs was 15 basis points during March 2006 as compared with 39 basis points during March 2005 (Table 39 and Chart 44).

Table 39: Treasury Bills in the Primary Market

Month	Notified Amount (Rupees 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
January	5,000	6.25	6.22	6.21	2.86	2.83	2.72
February	5,000	6.63	6.74	6.78	3.04	2.07	2.71
March	6,500	6.51	6.66	6.66	4.17	3.43	3.36

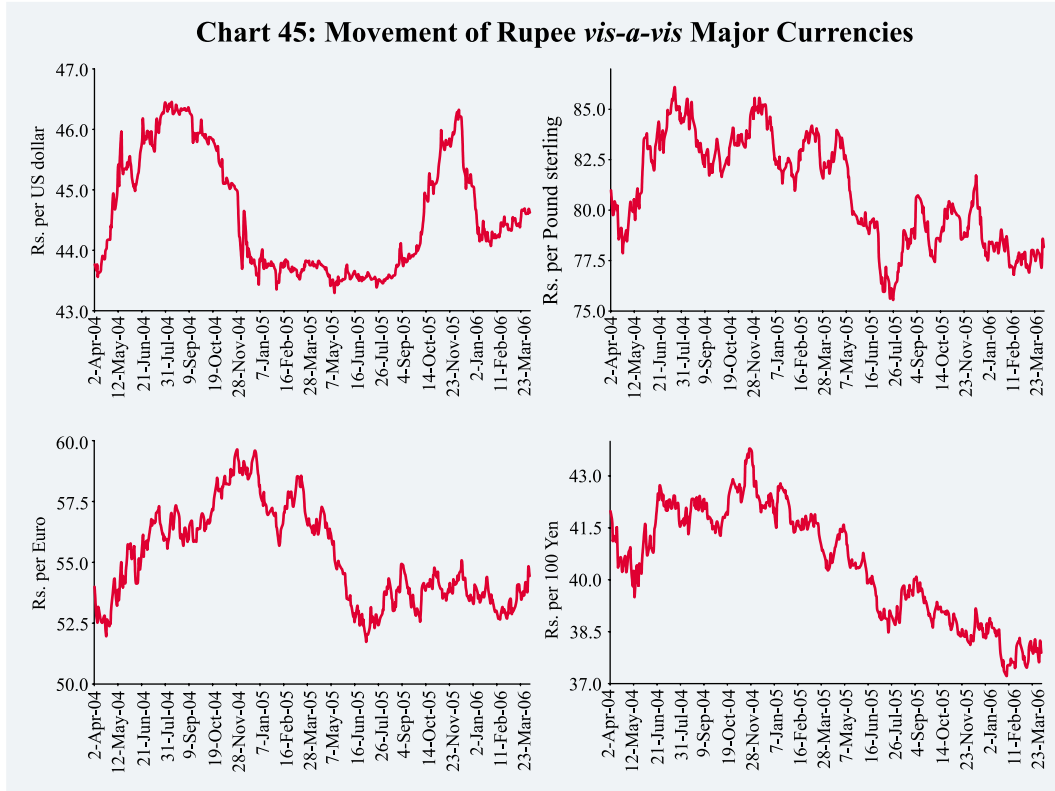
Note : 182-day TBs were reintroduced with effect from April 2005.



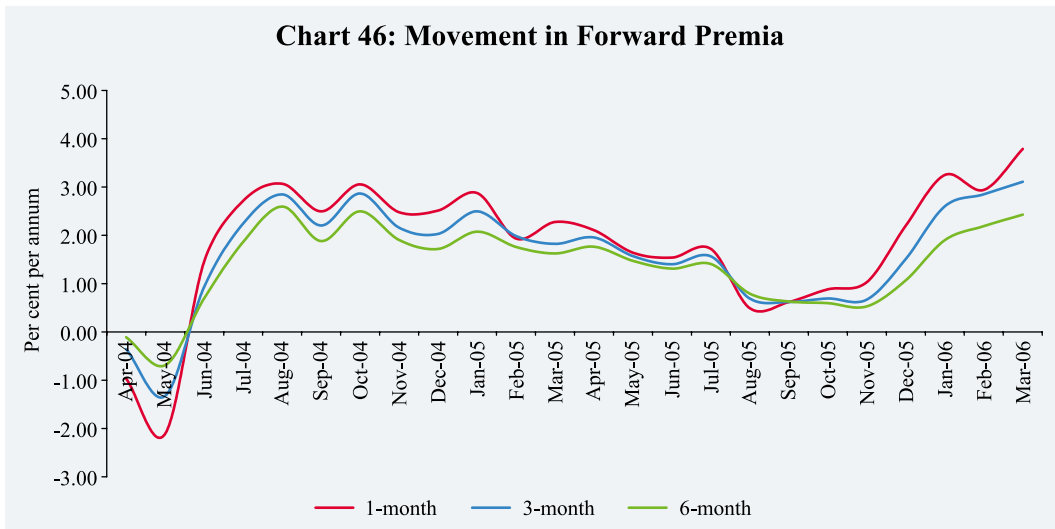
Foreign Exchange Market

In the foreign exchange market, the Indian rupee exhibited two-way movement *vis-à-vis* the US dollar during 2005-06, moving in a range of Rs.43.30–46.33 per US dollar. 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 reached 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 from end-August 2005 under the impact of high oil prices, sharp increase in the current account deficit and strong US dollar. The exchange rate moved to 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 sharply beginning with the second half of December 2005. It touched Rs.44.07 per US dollar on January 31, 2006. During February-March 2006, the rupee was largely range-bound and stood at Rs.44.61 per US dollar as on March 31, 2006 and at this level, the Indian rupee depreciated by 1.9 per cent over its level on March 31, 2005. Reflecting cross-currency movements, the rupee, however, appreciated against the other major international currencies during 2005-06, *i.e.*, 4.4 per cent against the Euro, 5.5 per cent against the Pound sterling and 7.3 per cent against the Japanese yen (Chart 45). The exchange rate of the Indian rupee was Rs. 44.92 per US dollar as on April 12, 2006.

Forward premia declined during the first half of 2005-06 in tandem with the narrowing of interest differential following the higher pace of monetary



tightening in the US. The premia, however, increased during December 2005-March 2006, reflecting higher domestic call money rates (Chart 46).



Credit Market

The demand for credit from the commercial sector strengthened further during 2005-06. The non-food credit extended by scheduled commercial banks as on March 31, 2006 grew (year-on-year) by 30.8 per cent on top of 28.8 per cent growth a year ago (net of conversion). Demand for bank credit was broad-based led by agriculture, industry and personal loans (housing, credit cards, education) sectors (Table 40). Disaggregated data show that almost 26 per cent of incremental non-food credit during April-January 2005-06 went to the industrial sector, while almost

Table 40: Deployment of Non-food Bank Credit

(Amount in Rupees crore)					
Sector/Industry	Outstanding as on January 20, 2006	Financial Year Variations			
		2004-05 (Apr-Jan)		2005-06 (Apr-Jan)	
		Absolute	Per cent	Absolute	Per cent
1	2	3	4	5	6
Non-food Gross Bank Credit (1 to 6)	12,56,368	1,34102	18.4	2,56,580	25.7
1. Agriculture and Allied Activities	1,53,339	17,155	18.9	28,089	22.4
2. Industry (Small, Medium and Large)	4,93,372	35,485	11.3	66,480	15.6
Small Scale Industries	82,041	3,211	4.9	7,453	10.0
3. Services	42,633	n.a.	n.a.	12,049	39.4
Transport Operators	11,589	n.a.	n.a.	1,990	20.7
Professional & Others	14,774	n.a.	n.a.	1,513	11.4
4. Personal Loans	3,13,466	n.a.	n.a.	68,386	27.9
Housing	1,66,159	n.a.	n.a.	37,431	29.1
		(20,581)	(39.6)		
Advances against Fixed Deposits	32,228	-585	-2.2	2,378	8.0
Credit Cards	8,832	n.a.	n.a.	3,072	53.3
Education	9,003	n.a.	n.a.	3,884	75.9
Consumer Durables	8,863	-211	-2.6	-220	-2.4
5. Trade	71,923	6,601	26.5	13,975	24.1
6. Others	1,81,635	74,861	25.0	67,601	59.3
Real Estate Loans	24,527	4,150	74.4	11,225	84.4
Non-Banking Financial Companies	28,507	-24	-0.1	6,023	26.8
<i>Memo:</i>					
Priority Sector	4,59,648	48,303	18.3	78,172	20.5
Industry (Small, Medium and Large)	4,93,372	35,485	11.3	66,480	15.6
Food Processing	28,311	187	0.9	3,878	15.9
Textiles	52,966	2,823	8.3	8,989	20.4
Paper & Paper Products	8,532	-283	-4.7	1,650	24.0
Petroleum, Coal Products & Nuclear Fuels	17,772	1,609	13.1	2,203	14.1
Chemical and Chemical Products	44,757	-460	-1.5	5,265	13.3
Rubber, Plastic & their Products	6,069	298	11.5	2,403	65.5
Iron and Steel	43,842	1,147	4.4	7,841	21.8
Other Metal & Metal Products	13,682	1,349	16.5	2,046	17.6
Engineering	32,309	-904	-3.4	2,913	9.9
Vehicles, Vehicle Parts and Transport Equipments	16,826	556	10.5	4,964	41.8
Gems & Jewellery	18,582	1,678	18.3	4,276	29.9
Construction	11,818	1,838	30.7	3,696	45.5
Infrastructure	1,01,726	16,884	32.9	22,717	28.8
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. Owing to change in classification of sectors/industries and coverage of banks, data for 2005-06 are not comparable with earlier data. Figures in parentheses for 2004-05 pertain only to housing loans of above Rs.15 lakhs. Data on housing loans for 2005-06, on the other hand, are also inclusive of loans less than Rs.15 lakhs.					

15 per cent of incremental non-food credit was on account of housing loans and another 11 per cent of incremental credit was absorbed by the agricultural sector and allied activities. The increase in industrial credit in consonance with sustained growth in domestic industrial production was mainly on account of infrastructure (*viz.*, power, roads, ports and telecommunications), textiles, iron and steel, chemicals, vehicles, gems and jewellery, food processing and construction. Infrastructure sector alone accounted for more than a third of incremental credit to the industry, while textiles and iron and steel industries absorbed another one-fourth of the incremental credit to the industry. Credit to agriculture recorded a robust growth, reflecting the impact of various policy initiatives to improve the flow of credit to the sector. Credit to the housing sector continued to be strong, benefiting from low interest rates and tax incentives. Apart from housing, strong credit demand emanated for education and other personal loans as well as from credit card holders. Credit to the commercial real estate increased sharply, although it still constitutes only a small part - less than two per cent of outstanding non-food bank credit and around four per cent of incremental non-food credit. Loans to shipping and tourism related companies also recorded a sharp rise.

As noted in Section III, banks were able to finance the sustained credit demand through liquidation of their investments in Government as well as non-SLR securities, continuous access to funding from FIs, raising of capital through equity issuances, higher internal resources and higher deposit mobilisation.

During the second half of 2005-06, banks increased their deposit rates by about 75-100 basis points across various maturities (Table 41). As regards lending rates, some private sector banks increased their Benchmark Prime Lending Rates (BPLRs), while some other banks revised upwards their sub-PLRs.

Government Securities Market

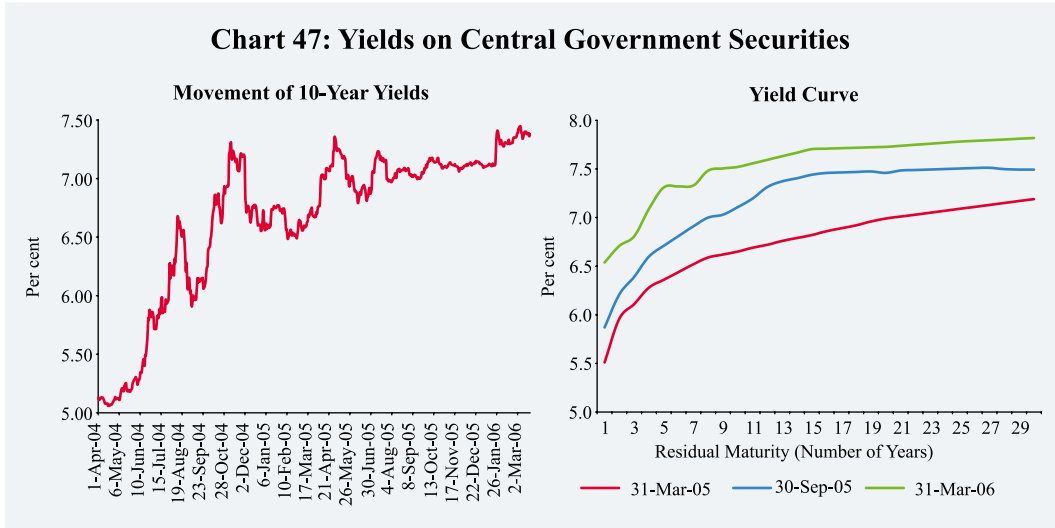
Yields in the Government securities market hardened during 2005-06, with the increase being more pronounced at the short-end of the market. Intra-year movements in yields were influenced by domestic liquidity conditions, inflationary expectations, volatility in crude oil prices and movements in US yields. Yields edged higher in 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, driven by 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

Table 41: Movements in Deposit and Lending Rates

Interest Rate	(Per cent)					
	March 2004	March 2005	June 2005	September 2005	December 2005	March 2006 @
1	2	3	4	5	6	7
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	2.25-6.25
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	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	6.25-7.00
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	3.50-7.00
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	5.50-7.75
More than 3 years	5.25-7.00	5.75-7.00	5.50-7.25	5.75-7.25	6.00-7.25	5.75-7.75
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	3.00-6.15
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	3.65-6.50
More than 3 years	3.25-8.00	3.50-7.00	4.00-7.00	4.00-7.00	5.00-7.00	4.05-6.50
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	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	11.00-14.00
Foreign Banks	11.00-14.85	10.00-14.50	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	4.00-16.50	4.00-16.50	n.a.
Private Sector Banks	3.00-22.00	3.15-22.00	3.15-24.94	3.15-20.22	3.15-20.50	n.a.
Foreign Banks	3.75-23.00	3.55-23.50	4.00-25.00	2.86-25.00	2.86-24.00	n.a.
n.a. : Not available. @ : As on March 17, 2006.						
* : 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.						

liquidity conditions, yields softened, reaching 6.98 per cent on July 29, 2005. Although the reverse repo rate was increased by 25 basis points in the Mid-Term Review (October 25, 2005) and the money markets were marked by liquidity tightness during November-December 2005, the yields remained broadly stable - hovering at around seven per cent - during August-December 2005 on the back of easing of headline inflation. The yields edged up during January 2006 in tandem with an increase in the reverse repo rate by 25 basis points in the Third Quarter Review (January 24, 2006) and remained largely range bound during February-March 2006. The 10-year yield was 7.52 per cent on March 31, 2006, 87 basis points higher than its end-March 2005 level. The spread between 1-year and 10-year yields narrowed to 98 basis points at end-March 2006 (from 114 basis points at end-March), mirroring liquidity tightness in money markets. The spread between 10-year and 30-year yields narrowed to 30 basis points (from 54 basis points at end-March), reflecting increased appetite for long-term securities from non-bank participants such as insurance companies and pension funds (Chart 47). The 10-year yield was 7.56 per cent as on April 12, 2006.

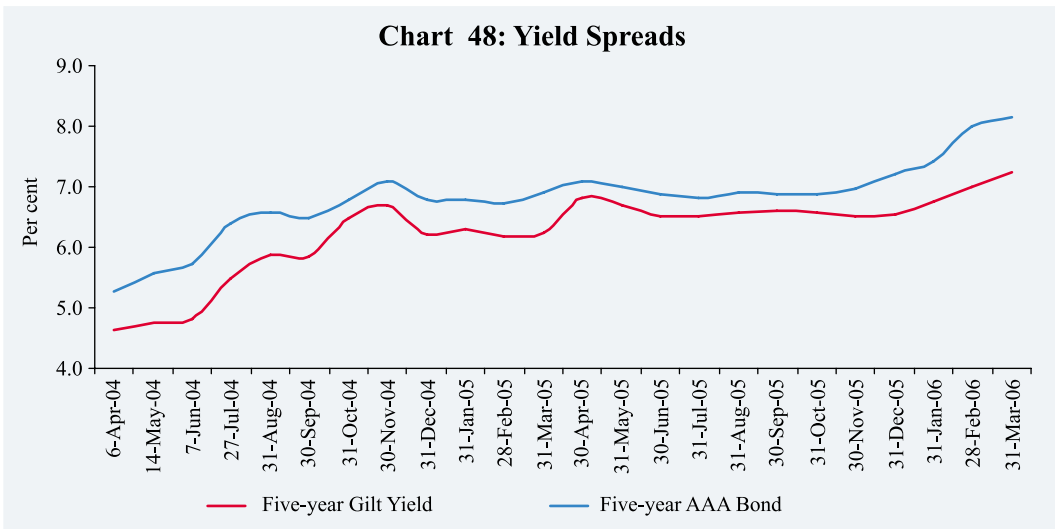
The yields on 5-year AAA-rated corporate bonds increased during 2005-06 in tandem with higher yields in Government securities. The yield spread over 5-



year Government securities - after remaining broadly stable at 30 basis points during April-October 2005 - increased to 98 basis points at end-March 2006 from 67 basis points at end-March 2005 (Chart 48).

Equity Market

The capital market exhibited buoyancy during 2005-06, with the benchmark stock indices reaching record highs driven by strong support from foreign institutional investors (FIIs) and domestic mutual funds on the back of robust macroeconomic fundamentals, congenial investment climate and strong corporate profitability. Resources raised by the Indian corporates through initial



public offerings, private placements and Euro issues increased significantly. Resource mobilisation by mutual funds also increased sharply.

Primary Market

Resources raised through the public issues increased by 50.5 per cent to Rs.25,649 crore during April-February 2005-06 (Table 42). However, the average size of issue declined to Rs.217 crore from Rs.370 crore during the corresponding period of the previous year. Non-Government public limited companies (private sector) accounted for the bulk (77.4 per cent) of the resources mobilised. Out of 118 issues, 67 issues were initial public offerings (IPOs), constituting 47.0 per cent of resource mobilisation as compared with 19 out of 46 issues being IPOs during the corresponding period of the last year (constituting 25.2 per cent of resource mobilisation). All the IPOs in the current financial year so far have been by companies in the private sector, barring one which was from a public sector non-financial company. Resource mobilisation by way of debt issues during April-February 2005-06 was less than one per cent of total resource mobilisation from the public issues market.

Table 42: Mobilisation of Resources from the Primary Market

Item	(Amount in Rupees crore)			
	April-February 2004-05		April-February 2005-06 P	
	No. of Issues	Amount	No. of Issues	Amount
1	2	3	4	5
A. Prospectus and Rights Issues*				
1. Private Sector (a+b)	43	12,020	111	19,863
a) Financial	9	5,108	9	7,575
b) Non-financial	34	6,912	102	12,288
2. Public Sector (a+b+c)	3	5,018	7	5,786
a) Public Sector Undertakings	-	-	-	-
b) Government Companies	1	2,684	1	373
c) Banks/Financial Institutions	2	2,334	6	5,413
3. Total (1+2)	46	17,038	118	25,649
<i>Of which:</i>				
(i) Equity	43	13,729	117	25,531
(ii) Debt	3	3,309	1	118
B. Private Placement +				
1. Private Sector	533	25,543	672	29,547
a) Financial	198	13,894	281	18,242
b) Non-financial	335	11,649	391	11,305
2. Public Sector	121	23,345	108	37,741
a) Financial	79	14,320	84	25,477
b) Non-financial	42	9,025	24	12,264
3. Total (1+2)	654	48,887	780	67,288
<i>Memo:</i>				
Euro Issues	11	2,606	43	10,099

P : Provisional. * : Excluding offers for sale. - : Nil/Negligible. + : April-December 2005.

Mobilisation of resources through private placement increased by 37.6 per cent during April-December 2005 as compared with an increase of 15.4 per cent during April-December 2004 (Table 42). This was mainly on account of a turnaround in resources mobilised by public sector entities - an increase of 61.7 per cent during April-December 2005 as against a decline of 21.1 per cent during April-December 2004. Public sector entities accounted for 56.1 per cent of total mobilisation through private placement during April-December 2005 as compared with 47.8 per cent during the same period of last year. Resources raised by financial intermediaries (both from public sector and private sector) accounted for 65.0 per cent of the total mobilisation by private placement during April-December 2005 (57.7 per cent during April-December 2004).

In addition to domestic issuances, the Indian corporates also took a large recourse to Euro issues – American Depository Receipts (ADRs), Global Depository Receipts (GDRs) and Foreign Currency Convertible Bonds (FCCBs). Amounts mobilised through the euro issues more than trebled to Rs.10,099 crore during April-February 2005-06 (Table 42).

Net mobilisation of funds (net of redemptions) by mutual funds also increased substantially by 591.0 per cent to Rs.44,973 crore during April-February 2005-06 over the corresponding period of the previous year (Table 43). Net inflows were witnessed in the case of both income/debt-oriented schemes and growth/equity-oriented schemes.

Secondary Market

The stock markets witnessed bullish conditions during 2005-06 with the benchmark indices touching all time high levels, driven mainly by support from the FIIs on the back of strong macroeconomic fundamentals of the Indian economy, congenial investment climate, sound business outlook and robust corporate earnings (Table 44). Profits after tax of sample non-financial non-Government companies recorded a growth of more than 40 per cent for 11 successive quarters from October-December 2002 to April-June 2005. Subsequently, growth in profitability decelerated, but still remains high given the strong base of the previous

Table 43: Resource Mobilisation by Mutual Funds

Mutual Fund	(Rupees crore)						
	2004-05 (April-February)			2005-06 (April- February)			
	Gross Mobilisation	Net Mobilisation @	Net Assets *	Gross Mobilisation	Net Mobilisation @	Net Assets *	
1	2	3	4	5	6	7	
Private Sector	6,51,929	9,192	1,21,114	8,00,735	32,756	1,67,021	
Public Sector	50,244	216	11,303	97,019	9,628	23,067	
UTI	40,006	-2,899	20,836	63,996	2,589	27,619	
Total	7,42,179	6,509	1,53,253	9,61,750	44,973	2,17,707	

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

Macroeconomic and Monetary Developments in 2005-06

Table 44: Corporate Financial Performance

1	2003-04	2004-05	2004-05 (April- December)	2005-06 (April- December)	(Growth rates in per cent)						
	2	3	4	5	2004-05				2005-06		
					Q1	Q2	Q3	Q4	Q1	Q2	Q3
6	7	8	9	10	11	12					
Sales	15.4	25.2	25.9	15.7	24.8	23.7	24.1	21.0	18.5	16.4	13.2
Expenditure	12.5	24.0	24.9	15.3	23.4	22.4	24.3	19.8	18.0	16.3	12.7
Gross Profit	26.6	38.9	37.8	24.1	36.0	35.8	30.5	35.3	32.0	19.1	21.2
Interest Cost	-11.5	-2.0	-2.1	-6.4	-3.2	2.1	-13.0	-5.4	-13.5	-8.0	4.6
Profits After Tax	57.9	53.8	48.0	35.0	51.2	45.3	45.5	51.4	54.2	27.5	27.0
Memo:											
(Amount in Rupees crore)											
No. of Companies	2,201	1,273	895	2,010	1,255	1,353	1,464	1,301	2,355	2,361	2,366
Sales	4,28,072	5,68,476	3,63,140	5,77,271	1,35,156	1,53,040	1,62,193	1,79,632	1,94,608	2,12,693	2,19,098
Expenditure	4,06,838	4,90,204	3,11,105	4,95,121	1,15,656	1,31,227	1,40,574	1,56,647	1,66,972	1,83,717	1,88,934
Gross Profit	48,852	72,406	47,591	77,286	17,234	20,448	20,017	23,736	25,577	27,620	28,135
Interest Cost	14,724	12,528	7,831	12,140	3,597	3,584	3,273	3,177	4,241	4,467	4,555
Profits After Tax	26,281	47,333	31,066	51,364	10,396	13,004	13,196	16,798	16,726	18,169	18,790

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.

quarters. Liquidity support from mutual funds, firm trends in the major international equity markets and surge in ADR prices also buoyed up stock markets. Positive measures announced in the Union Budget, 2006-07 such as raising FII investment limit in Government securities and corporate debt, treating open-ended and close-ended equity-oriented schemes on par for dividend distribution tax, rationalisation of excise duties and relaxation in fringe benefit tax also helped to boost the market sentiment. Reflecting all these factors, the BSE Sensex reached an all time high level of 11,747 on April 5, 2006 (Chart 49).

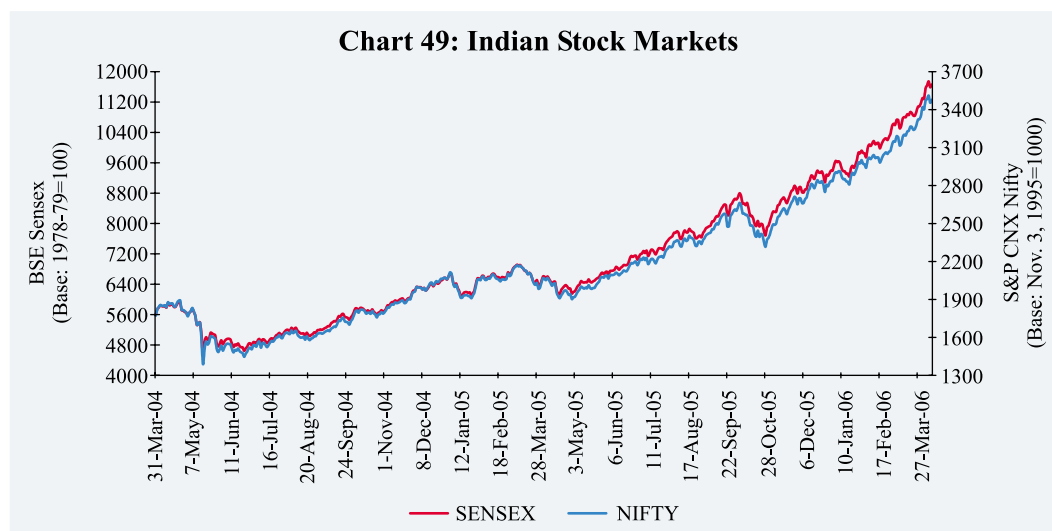


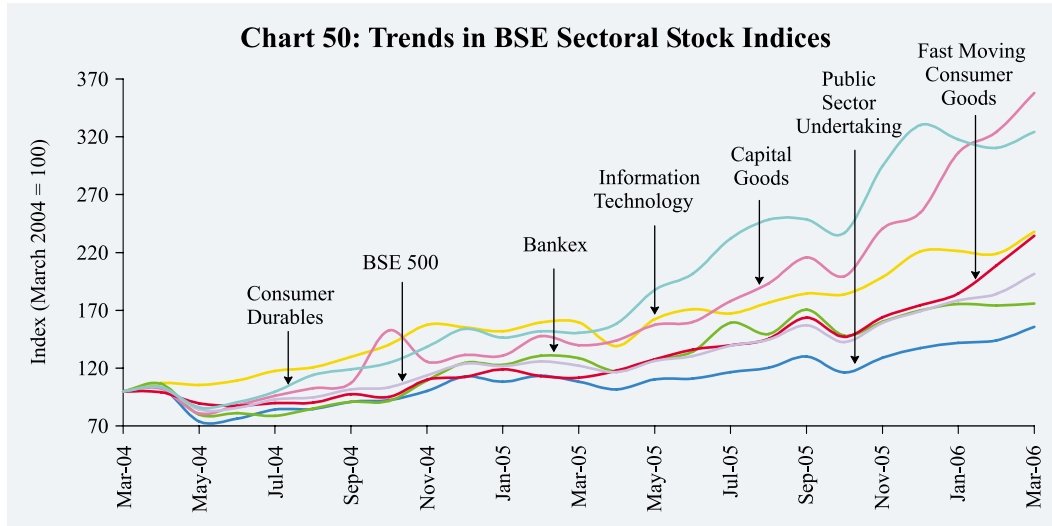
Table 45: Stock Market Indicators

Indicators	BSE			NSE		
	2003-04	2004-05	2005-06	2003-04	2004-05	2005-06
1	2	3	4	5	6	7
BSE Sensex / S&P CNX Nifty						
End-period	5591	6493	11280	1772	2036	3403
Average	4492	5741	8280	1428	1805	2517
Volatility (CV)	22.95	11.16	16.68	23.30	11.28	15.59
P/E Ratio (End-period)*	18.57	15.61	20.92	20.70	14.60	20.26
Turnover (Rupees crore)	5,03,053	5,18,716	8,16,074 P	10,99,535	11,40,071	15,69,555
Market Capitalisation (Rupees crore) (End-period)	12,01,207	16,98,429	30,22,189	11,20,976	15,85,585	28,13,201
P: Provisional. CV: Coefficient of Variation.						
* : 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).						

The market witnessed some correction on April 12, 2006 and the BSE Sensex was 11,356 as on April 12, 2006.

The BSE Sensex increased by 73.7 per cent between end-March 2005 and end-March 2006, while the S&P CNX Nifty increased by 67.2 per cent over the same period. The price-earnings (P/E) ratios increased during the year; for instance, the P/E ratio for the 30 scrips included in the BSE Sensex increased from 15.6 at end-March 2005 to 20.9 at end-March 2006. The total turnover in the cash segment increased sharply during 2005-06. The market capitalisation also surged on account of increase in stock prices as well as listing of new securities. The volatility in terms of coefficient of variation increased during 2005-06 as compared with the previous year (Table 45).

The rally in the stock markets during 2005-06 was wide-spread (Chart 50). On a point-to-point basis, while BSE 500 increased by 65.2 per cent, BSE Small-cap and BSE Mid-cap increased by 76.9 per cent and 73.6 per cent, respectively. Amongst the major sectors, BSE capital goods index registered the highest gain (156.0 per cent), followed by consumer durables (115.4 per cent), fast moving consumer goods (FMCG) (109.9 per cent), IT sector (49.2 per cent), public sector undertakings (PSUs) (44.0 per cent) and banking sector (36.8 per cent). Gains by the capital goods stocks reflected the pick-up in investment activity and the Government's emphasis on infrastructure developments in the Union Budget, 2006-07. The consumer durables stocks were buoyant on the back of strong growth in sales, good financial results of some of the companies and mergers and acquisitions in the sector. The FMCG stocks benefited from the normal progress of monsoon and its positive effect on sales, and abolition of excise duty on branded foods and reduction in excise duty from 16 per cent to 8 per cent on select fast food items in the Union Budget, 2006-07. Banking sector scrips gained due to several factors such as pick up in non-food credit of the banks and permission to banks to issue perpetual bonds and other hybrid instruments. Favourable proposals in the Union



Budget, 2006-07 relating to the banking sector such as conversion of non-tradable special securities into tradable SLR Government of India dated securities, and inclusion of fixed deposits of scheduled banks of maturity not less than 5 years in Section 80C of the Income Tax Act also boosted the banking sector scrips.

According to the Securities and Exchange Board of India (SEBI) data, foreign institutional investors (FIIs) made net investment of Rs.48,487 crore (US \$ 10.9 billion) in the equity market during 2005-06 on top of net purchases of Rs.40,991 crore (US \$ 9.1 billion) during the previous year (Chart 51). Mutual funds also made net purchases in equities of Rs.14,308 crore during 2005-06 as compared with net purchases of only Rs.448 crore during the previous year.

